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Highlights

AICPA PROPOSES, ADOPTS ETHICS GUIDANCE

The Institute's Professional Ethics Executive Committee (PEEC) issued an exposure draft (ED) (**www.aicpa.org/download/ethics/2005_0915_ed_int101-1.pdf**) proposing an independence standards revision that would require members to use the risk-based approach described in *A Conceptual Framework for AICPA Independence Standards* (**www.aicpa.org/download/ethics/AICPA_Draft_Conceptual_Framework_FINAL.pdf**) when considering whether a member-client relationship not specifically addressed by the Code of Professional Conduct "would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence." In addition, if the threat to independence is not at an acceptable level—as described in the framework—the proposal requires members to document the threat and the safeguards applied.

Another exposure draft from the PEEC proposes two new interpretations (**www.aicpa.org/download/ethics/2005_0915_ed_indemn.pdf**) under Rule 101, Independence (**www.aicpa.org/about/code/et_100.html**). The first proposal provides guidance on the impact that certain indemnification and limitation of liability provisions may have on a member's independence when they are included in engagement letters or other client agreements. The second proposal provides guidance on the impact on a member's independence associated with rendering litigation and forensic accounting services to attest clients. Comments on both EDs are due December 16, 2005.

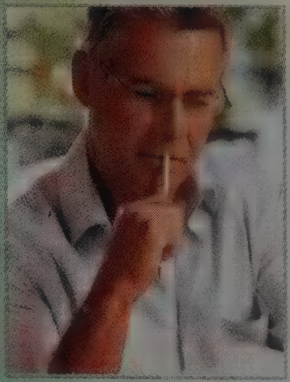
The PEEC also adopted a new ethics interpretation, 101-15, "Financial Relationships" (**www.aicpa.org/download/ethics/interp101_1.pdf**), that defines the terms *financial interest*, *direct financial interest* and *indirect financial interest* as used in Ethics Interpretation 101 under Rule 101 (AICPA, *Professional Standards*, volume 2, ET section 101.01) and provides guidance on determining whether financial interests should be considered direct or indirect.

BANKS GET MORE TIME FOR BROKER COMPLIANCE

The SEC again extended—this time to September 30, 2006—the date by which banks must comply with certain broker registration requirements under the Gramm-Leach-Bliley Act (GLBA) (**www.sec.gov/news/press/2005-130.htm**). Under GLBA, a bank engaging in securities activities must either conduct them through a registered broker-dealer or ensure such activities fall within the *limited* exceptions to the terms *broker* and *dealer* granted banks under the act—which repealed the *blanket* exception banks formerly held. While the commission considers comments on a proposed regulation to implement the act's provisions, it continues to postpone the date by which banks must follow interim SEC rules passed earlier.

NO EXTRAORDINARY TREATMENT FOR KATRINA LOSSES

Lawrence W. Smith, chairman of FASB's Emerging Issues Task Force, said neither the task force nor the board will provide specific accounting guidance for the events related to Hurricane Katrina. He directed CPAs instead to AICPA Technical Practice Aid 5400.05, *Accounting and Disclosures for Losses from Natural Disasters—Nongovernmental Entities* (**www.aicpa.org/members/div/acctstd/general/recent_tpas.asp**; see News Digest, page 23), which summarizes existing GAAP for issues related to natural disasters.



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Learn more. Visit accountant.intuit.com/go/qbpayroll or call 1.888.236.9501

Letters

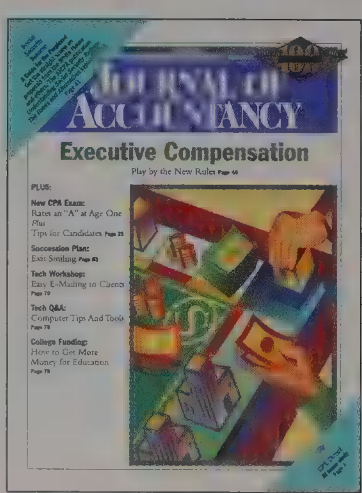
Technology Column Gets an A

Once again Technology Q&A discussed an Excel feature that previously I had noticed only in passing. My knowledge of hyperlinks was limited to guessing they had something to do with Web sites. After reading "Create an Excel Contents Tab" (*JofA*, Aug.05, page 87) and playing with the menu for a few minutes, I much better understand the application of the feature. I had a similar experience with the discussion of conditional formatting ("Shade Alternating Rows or Columns," page 88).

I live and breathe Excel in my daily work. However, it seems there often are features and tricks I had no knowledge of that may improve my work or make it more interesting. I get more information that directly affects me from this monthly column than the rest of the *JofA*. Keep up the great work.

John Keegan
Controller
Duferco Steel Inc.
Oakhurst, N.J.

Former Andersen Partner Speaks Out



Barry Melancon's Letter From the President (*JofA*, Jul.05, page 8) is self-serving and misleading. One might wonder why a retired Andersen partner and former chairman of the AICPA Tax Section (that would be me) would be critical of that letter or express anything but appreciation for the AICPA's assistance in the recent Supreme Court case, which overturned Andersen's criminal conviction.

Andersen committed no crime, and in fact followed professional standards, in removing extraneous papers from the files.

The letter points out that

The Supreme Court vindication of Andersen is "a bittersweet victory" for all 28,000 ex-Andersen employees (and, I'd add, partners);

The AICPA filed an *amicus curiae* brief supporting Andersen's successful position; and

None of us can ever know how Andersen would have fared "without the criminal verdict."

So, what is my problem with the AICPA and with Mr. Melancon's letter? The AICPA's actions were too little and much too late. The indictment of the firm, not the conviction, brought Andersen down. I cannot recall, and have been unable to find, evidence of expressed AICPA support for AA and opposition to the indictment at a time when they might have had some actual impact. I understand the AICPA did many things behind the scenes, but I would have preferred more public support at the time.

Mr. Melancon's letter seems to be an attempt to take credit on behalf of the AICPA for its recent actions that may have helped Andersen achieve its 9-0 Pyrrhic victory. The reason for filing the *amicus* brief was that "other CPAs might be subject to the statute that laid the foundation for the government's case." But how will that help other CPAs whose firms might be destroyed by a mere decision to indict the firm?

Press reports indicate that KPMG escaped immediate indictment largely based on the lessons learned in Andersen. If the Supreme Court decision helps present and future firms, that is commendable, but the AICPA's failure to speak out when it might have really made a difference to Andersen and its personnel is deplorable.

Leonard Podolin, CPA
Haverford, Pa.

The Right Tools

Reading "Mass Mailings Made Simple" (*JofA*, Apr.05, page 48) reminded me of the old story about the handyman who owned only a screwdriver, so he used the handle to drive nails. While the article is interesting, it does not do the accounting profession a service.

Why do so many of my CPA brethren continue to waste their most valuable asset—time—using screwdrivers instead of the right tools? Technology is a tool begging to be used.

With products such as ACT!, Sage CRM and SalesLogix, mass mailings are simple to create. Too often, when I consult to members of our profession, I understand why so many of their

Letters to the Editor

The JofA *encourages readers to write letters on important professional issues in addition to comments on published articles. Because space is limited, letters submitted for publication should be no longer than 500 words. Please include telephone and fax numbers.* JofA *e-mail address: JOAED@aicpa.org.*

clients are afraid to invest in being more efficient: Their trusted advisers are often too lacking in knowledge to point them in the right direction.

Let's publish articles that point us to the future, not bury us in the past.

Arthur E. Nathan, CPA/CITP
President
Solution Strategists, Inc.
Cranford, N.J.

Authors' reply: We agree there are other products designed to facilitate the creation of mailing lists, and these products do a great job. However, the purpose of this article was to show how easy it is to use Microsoft Word, an application found on most desktops, to do simple mail-merge tasks. In our experience, we have seen many people who are unaware of Word's built-in capabilities.

For others, Word's functionality is more than sufficient, and they already are familiar with the interface. Our research indicates that people prefer to use Microsoft Office when possible, even when specialty applications exist that are more powerful.

We encourage readers who plan to spend a large portion of their time doing mass mailings to buy and learn to use an application specifically designed for that. For simple mass mailings, Word does a good job, and you don't have to buy and learn another software package.

Bonnie Brinton Anderson, PhD
Larysa V. Oprya
Marshall B. Romney, CPA, PhD
Brigham Young University
Provo, Utah

What About the Micro Firm?

I have long believed the AICPA was too involved with big firms, and not concerned enough with the one-, two- or three-partner firm.

When I read the article, "Nothing Succeeds Like Succession" (*JofA*, Jul.05, page 63), I noted the chart indicated a five-partner, three-manager firm with who knows how many staff. This was a good article for that size firm, but my question is, What should the two-partner, three-staff person do? I don't know how many of us are in small firms vs. bigger, but in my town the average is probably two partners, three staff. If you want the small practitioner to get his money's worth from membership, you need to address our part of the marketplace. How about a succession-planning article for the micro firm?

Ken Gardner, CPA
Boulder, Colo.

Editor's note: Here are a few features the *JofA* has published on this topic that are of interest to smaller firms: "Price Equals Value Plus Terms" (Dec.04, page 67); "Who Will Take the Reins?" (Aug.04, page 45); "Have a Fallback Plan" (Sep.03, page 57); "The Single-Participant 401(k)" (Mar.03, page 49). ■

Financial Management Web Site Opens

The AICPA creates a hub for members in business and industry to connect with colleagues, keep current on business ideas and access tools and research.

WHAT IT IS

The Financial Management Center is a Web site that provides organization decision makers, financial executives and financial management professionals with a wide variety of resources, tools and information about financial and management accounting, including the traditional areas of reporting, audit and tax, in one convenient location. The Financial Management Center was designed primarily for those practicing the profession in business and industry; however, others also will find the resources helpful when accessing the center at **www.aicpa.org/fmcenter**.

The mission of the Financial Management Center is to

- Provide financial executives and their organizations with the tools and resources they need to move their organizations forward.
- Serve as a comprehensive, top-of-mind resource for financial executives and managers.
- Create a community resource where financial executives and financial managers can exchange ideas, discuss issues and connect with others sharing similar challenges in their organizations.

WHAT IT OFFERS

Six tabs conveniently organize the information.

Home. This is the front door to the site. Use the search engine. Look for spotlights on important events or alerts on pertinent news. Select tabs for more specific information.

Resources. Access the research tools, practice aids, specialized guidance, the Competency Assessment Tool (CAT) and other reference materials you need from one central location.

Community. Learn about emerging issues and how they are affecting your peers. Connect and discuss. Locate a committee member here.

Events. A convenient listing of relevant conferences and webcasts for our members in business and industry to help you keep on top of what is happening.

Products. Find products and tools you need.

Membership. Learn the benefits of AICPA membership.

The AICPA is committed to supporting its members in business and industry, and therefore, the Financial Management Center has been created with the needs of these members in mind. Financial executives' and financial managers' responsibilities are vast and cannot be neatly described through titles. Human resources issues, corporate governance, organization vision and direction, along with traditional financial responsibilities, all fall within the financial executive's role in an organization. "As management concepts and practices continue to evolve, so will the Financial Management Center—all in the spirit of supporting our members to grow the beans of their companies, organizations and governments," said John F. Morrow, CPA, AICPA vice-president, new finance.

The center's objective is to help our members retool and continuously develop new skills to meet the demands of their expanding roles as strategic business partners and advisers in their organizations. The educational content focuses not only on traditional accounting knowledge, but also includes *the new finance*, a term created by the AICPA to define the management of process, technology and resources—all areas of interest for CPAs who practice in companies, not-for-profit organizations and governments across the country. The new finance encompasses subjects such as shareholder value creation, capacity management, competitive intelligence, just-in-time production systems and value-chain analysis.

"We have worked hard to increase the value propositions for our members in business and industry, and the Financial Management Center does just that," says Stuart Benton, CPA, chairman of the Business & Industry Executive Committee. "It creates a stopping point on the Web where CPAs in business and industry can find research tools, guidance and reference materials. Furthermore, the center starts to create a sense of community for this very diverse group of CPAs."

We welcome your comments and thoughts about the center as well as suggestions on the kind of information you need from us to help you perform optimally in your organization. Please feel free to write to us at fincenter@aicpa.org.

Visit the Financial Management Center: **www.aicpa.org/fmcenter**. ■

Top Line

NEWS, PEOPLE, TRENDS AND OTHER NOTEWORTHY ITEMS

SIGNS OF THE TIMES

An Inca 1040?

Think accounting is the invention of modern minds? Not likely. Two Harvard researchers are convinced that ancient Incas tracked inventory and taxes through a three-tiered accounting system using knotted bundles of threads.

The researchers—and many scholars pondering their report—believe the colorful knotted quipu strings found at a 13th century archaeological site near Lima, Peru, formed an early abacus system the Incas used to track the units of labor and time upon which taxes were based. The first two tiers of knots are double-entry accounts, they think, and the third is a summary of the numbers.

If their interpretation is accepted by the academic community, it will put to rest the "Inca paradox"—the question of why these early Americans had the only complex empire with no written form of communication. They may have had no novels, it seems, but they did indeed have "books."

—*Cheryl Rosen*

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ON THE RECORD

Bubbling Up

—Alan Greenspan, June 9 testimony to the Joint Economic Committee of Congress

"There can be little doubt that exceptionally low interest rates on 10-year Treasury notes, and hence on home mortgages, have been a major factor in the recent surge of homebuilding and home turnover, and especially in the steep climb in home prices. Although a 'bubble' in home prices for the nation as a whole does not appear likely, there do appear to be, at a minimum, signs of froth in some local markets where home prices seem to have risen to unsustainable levels.

"Although we certainly cannot rule out home price declines, especially in some local markets, these declines, were they to occur, likely would not have substantial macroeconomic implications. Nationwide banking and widespread securitization of mortgages make it less likely that financial intermediation would be impaired than was the case in prior episodes of regional house price corrections. Moreover, a substantial rise in bankruptcies would require a quite-significant overall reduction in the national housing price level because the vast majority of homeowners have built up substantial equity in their homes despite large home equity withdrawals in recent years financed by the mortgage market."

KEVIN LAMARQUE/REUTERS/CORBIS

I.Q. TEST

(Innocuous Question)

What's My Line?

Although some of these jobs still exist, most CPAs are not likely to see these titles on form 1040. Can you identify them?

1. Mercer
2. Collier
3. Cutler
4. Draper
5. Costermonger

—*Robert Lester Porter, CPA*

1. A dealer in textile fabrics.
2. A coal miner, one who works in a colliery.
3. One who makes, deals in or repairs cutlery.
4. A dealer in cloth or clothing.
5. One who sells from a wheelbarrow in the street; for example, fishmonger.

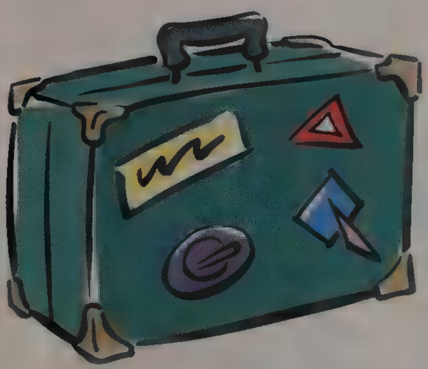
SURVEY SAVVY

KAREN MINOT ILLUSTRATION

NUMEROLOGY

Travel With Confidence

Americans spent more than $1 billion on travel insurance in 2004, more than 80% of it on per-trip policies that included cancellation coverage. The U.S. Travel Insurance Association says the top misconception consumers have about the need for travel insurance is that credit card companies or travel suppliers such as airlines or cruise lines will reimburse those who have to cancel trips. Despite this, more leisure travelers taking cruises, air/tour vacations and international trips last year did choose to protect their travel investment. An association survey showed 30% of them purchased travel insurance coverage—a significant increase from the estimated 8% to 10% of travelers who did so before September 11, 2001.

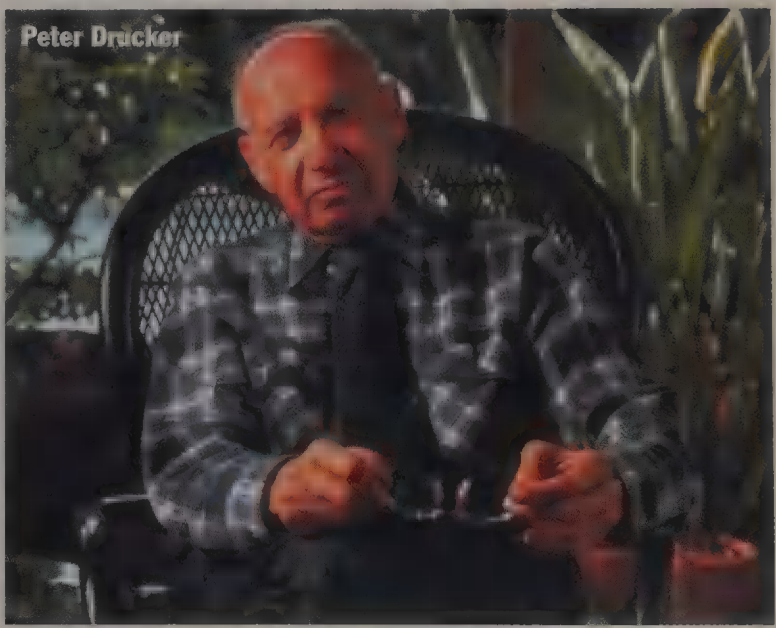


GOLDEN BUSINESS IDEA

Drucker on Motivation

Peter Drucker, the management guru, maintains that people motivate themselves. You can't motivate them; you can only thwart their motivation.

To be an effective leader you must recognize that the business you're really in is the obstacle identification and removal business.



TIME LIFE PICTURES/GETTY IMAGES

NUMEROLOGY

Five Facts About Your Credit

Things you should know to keep your credit rating healthy.

1 You have three credit reports. Each of the three national credit bureaus—Equifax, **www.equifax.com**; Experian, **www.experian.com**; and TransUnion, **www.transunion.com**—independently collects and maintains consumer financial records. The information on each credit report can be significantly different, though. Since you don't know which bureau a lender will use, it's important to check all three at least once a year.

2 It's safe to check your credit. Contrary to popular rumors, checking your own credit data will not harm your credit score. The rating drops only when a lender or creditor checks your credit for an application. You can safely monitor your own credit reports as often as you like.

3 Negative information expires after 7 to 10 years. Late payments and bankruptcy filings remain on your credit report for the full 7 to 10 years, even if you repay a debt or make changes to an account. Positive records, such as closed accounts that never were paid late, can stay on a report even longer.

4 Keeping active is key. One of the most important things consumers can do to keep their credit healthy is to use it. Use at least one credit card each month and pay all bills on time to consistently add new positive information to your credit report. If you allow cards to go dormant or close too many accounts, this positive reporting slows down and your credit score could drop. The longer you keep up stable credit activity, the better your score will be.

5 Good credit is up to you. Creditors and credit reporting agencies work diligently to maintain accurate records, but with millions of updates made each day, mistakes can happen. Only you can identify and report certain kinds of inaccuracies, including creditor errors and signs of identity theft. Review your credit reports regularly to check that the information is accurate and file disputes when you need to make corrections.

Source: TrueCredit, **www.truecredit.com**, a provider of consumer credit management services.

SIGNS OF THE TIMES

Telephones and Taxes

Pull out your cell phone bill—or even the one for your land line—and look at the long list of federal, state, county and local taxes. The Washington, D.C.-based Council on State Taxation (**www.statetax.org**) says state and local taxes imposed on telecommunications services are more than double the average levy on general business.

A council study showed the average effective state and local tax rate on telecom services to be 14.17% compared with only 6.12% on general business. The companies themselves bear part of the compliance burden—in 2004 the average provider filed 47,921 tax returns (over 170 returns per day) compared with only 7,501 returns for an average general business. This reflects the fact that telecom companies have more than 6,683 taxing jurisdictions to contend with.

HOME FRONT

Move or Improve?

Whether you decide to remodel your home or move to a new one, it could cost you big bucks. Here are some things to consider when making the decision.

Reasons to stay

- You will create the home you want.
- Remodeling can be a good investment.
- You like your neighborhood and the schools are good.
- You enjoy remodeling.

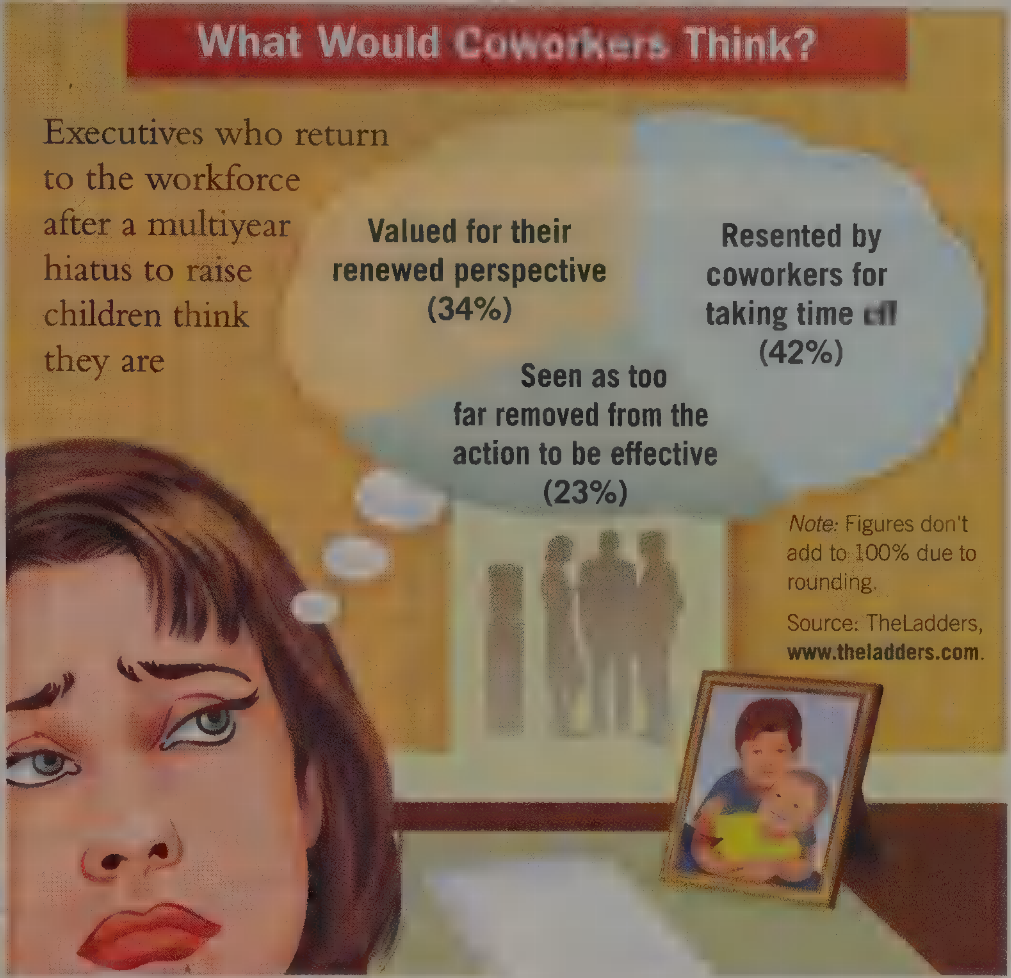
Reasons to move

- You want better schools.
- Your home has an awkward layout.
- Your home already is the largest and nicest on the block.
- You don't like your neighborhood.

Source: Adapted from *Remodel or Move? Make the Right Decision* by Dan Fritchen, ABCD Publishing LLC, 2005.

ILLUSTRATIONS BY TIM WEBB (2)

NUMEROLOGY



KAREN MINOT ILLUSTRATION

TOP 10

Cities for Entrepreneurs

Hot spots to start a business

- Minneapolis
- Norfolk/Virginia Beach/Newport News, Va.
- Washington, D.C.
- Atlanta
- Miami
- Fort Lauderdale, Fla.
- Charlotte/Gastonia/Rocky Hill, N.C.
- Salt Lake City
- West Palm Beach, Fla.
- Orlando, Fla.

Source: *Entrepreneur* and D&B, 2003.

TOP 10

Threats to Investors

These are some common ploys often used to cheat investors.

1. ***Ponzi schemes.*** Using money from later investors to pay early ones until the scheme collapses is an old con that still finds new victims.

2. ***Unlicensed individuals selling securities.*** Unlicensed sellers should be a red flag for investors.

3. ***Unregistered investment products.*** Most legitimate investments must be registered with the state before they can be offered for sale to the public.

4. ***Promissory notes.*** Notes marketed to the general public typically turn out to be scams. If the interest rate sounds too good to be true, it probably is.

5. ***Senior citizen investment fraud.*** Con artists continue to target the savings of retirees with fraudulent schemes. Before investing check with state securities regulators for proper licenses and any complaints against the broker.

6. ***High-yield investments.*** Risk-free, guaranteed high-yield instruments are usually none of these things.

7. ***Internet fraud.*** A bad deal isn't any better because it's offered on the Internet. Many online scams are new versions of old schemes.

8. ***Affinity fraud.*** Con artists are using victims' religious, ethnic or other affiliations to gain their trust and then steal their life savings.

9. ***Variable annuity sales practices.*** This product isn't suitable for everyone, particularly seniors. Sales reps frequently fail to disclose high surrender charges and steep sales commissions.

10. ***Oil and gas scams.*** With high oil prices and instability in the Middle East, regulators fear con artists may renew schemes promising investors easy profits on these commodities.

Source: North American Securities Administrators Association, Washington, D.C., **www.nasaa.org**.

ON THE RECORD

Nothing to Fear

John W. Green, CPA
Partner, Marcum & Kliegman LLP, Melville, N.Y.
Speaking at AccountantsWorld's CPE Symposium in New York

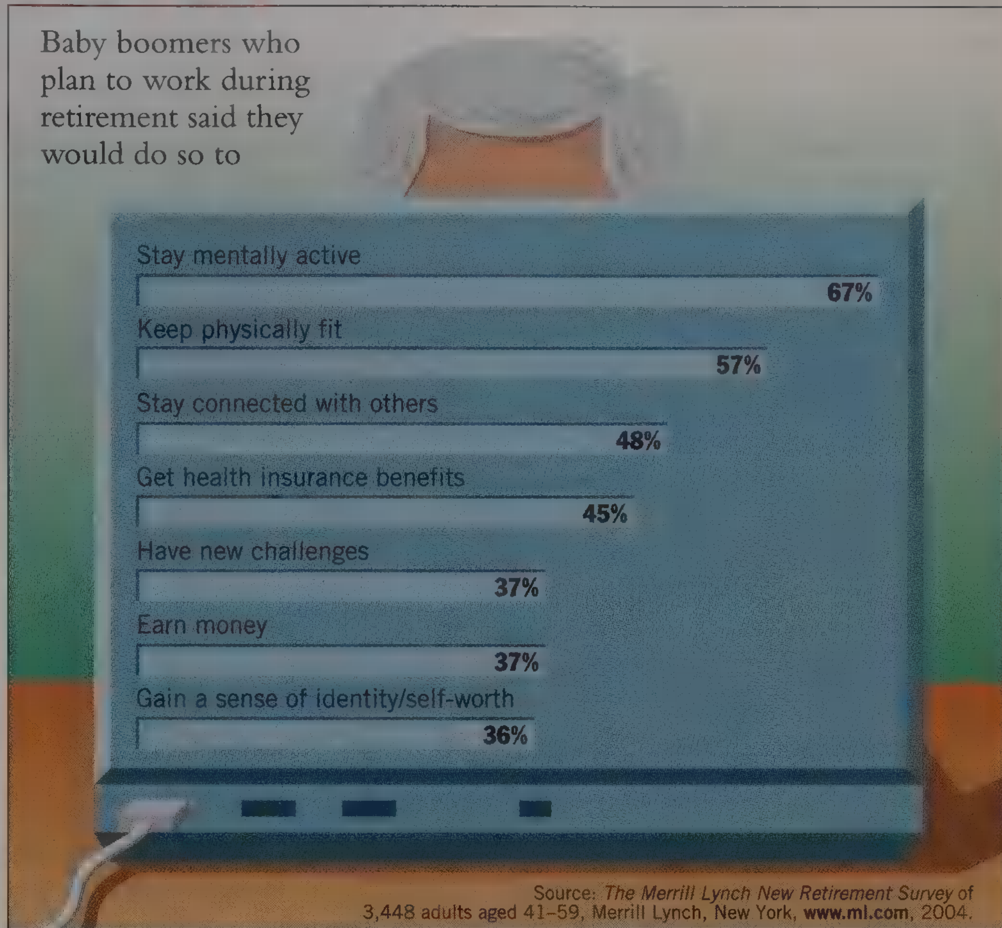
“We ought to call Sarbanes-Oxley the CPA Employment Act of 2002. I've been in public accounting since 1981 and I've never seen anything like this. Next year, when the nonaccelerated filers have to comply with section 404, we'll probably see a similar resource issue. The large-cap companies will continue to suck up the resources of the Big Four firms and smaller companies will move downstream—and companies that wait too long to begin their 404 compliance may have difficulty finding qualified accountants. So now's the time for CPAs to be bold and fight the fear of losing a client over fees. There's plenty of work out there.”

NEWS DIGEST

ACCOUNTING

FASB issued Staff Position (FSP) FAS 123(R)-1, *Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)* (**www.fasb.org/fasb_staff_positions/fsp_fas123r-1.pdf**). The board, which continues to believe freestanding financial instruments should be accounted for consistently, plans to consider broadly the distinction between liabilities and equity—a project that could significantly change other applicable GAAP. The FSP therefore defers the requirement in the statement, *Share-Based Payment*, that a freestanding financial instrument originally subject to the statement becomes subject to the recognition and measurement requirements of other applicable GAAP when the rights conveyed by the instrument to the holder no longer depend on his or her being an employee of the entity. The guidance is effective upon the entity's initial adoption of the statement.

Mind Over Money



Source: *The Merrill Lynch New Retirement Survey* of 3,448 adults aged 41–59, Merrill Lynch, New York, **www.ml.com**, 2004.

CHART: KELLEY GRAPHICS

The AICPA issued three accounting technical practice aids. TPAs 6930.09 and 6930.10 pertain, respectively, to single-employer and multiemployer benefit plans. Each TPA contains a question and answer on accounting and disclosure requirements related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. TPA 5400.05 identifies issues and relevant literature nongovernment entities should consider in their accounting and disclosures related to losses from natural disasters. All three TPAs are available at **www.aicpa.org/members/div/acctstd/general/recent_tpas.asp**.

For single-click access to further coverage of the news stories listed here, visit the *Journal of Accountancy* Web site at **www.aicpa.org/pubs/jofa/joahome.htm**.

For news from the AICPA and state societies, visit **www.cpa2biz.com**, which also offers online CPE, AICPA professional literature, practice management aids and links to state society Web sites.

AUDIT AND ATTEST

The Institute's Accounting and Review Services Committee (ARSC) released three statements on standards for accounting and review services (SSARSs) and an interpretation (see Official Releases, page 109). SSARS no. 12, *Omnibus Statement on Standards for Accounting and Review Services—2005* (# 060650JA); SSARS no. 13, *Compilation of Specified Elements, Accounts, or Items of a Financial Statement* (# 060651JA); and SSARS no. 14, *Compilation of Pro Forma Financial Information* (# 060652JA), can be ordered from **www.cpa2biz.com** or from the AICPA at 888-777-7077. The interpretation, "Applicability of SSARSs to Reviews of Nonissuers Who Are Owned by or Controlled by an Issuer," which relates to SSARS no. 1, *Compilation and Review of Financial Statements*, is available at **www.aicpa.org/download/members/div/auditstd/SSARS_Interpretation_SSARS_Applicability.pdf**. The ARSC also issued new and revised illustrative representation letters for engagements performed under the SSARSs, revised illustrative inquiries for review engagements and a revised illustrative successor accountant acknowledgement letter. These docu-

ments are available at **www.aicpa.org/members/div/auditstd/technic_arsc.asp**.

■ The AICPA's Auditing Standards Board issued two interpretations of statements on auditing standards: "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities" and "Auditing Interests in Trusts Held by a Third-Party Trustee and Reported at Fair Value" (**www.aicpa.org/download/auditstd/announce/audit_interpretations_auditing_fair_value.pdf**; see Official Releases, page 121). The interpretations clarify that when an auditor determines that the nature and extent of auditing procedures should include testing the measurement of investments in securities, simply receiving a confirmation from a third party does *not* constitute adequate audit evidence with respect to the valuation assertion. The interpretations also reiterate management's responsibility for establishing an accounting and financial reporting process for determining fair value measurements.

■ The AICPA issued three auditing technical practice aids (TPAs): *Consideration of Impact of Losses From Natural Disasters Occurring After Completion of Audit Field Work and Signing of the Auditor's Report But Before Issuance of the Auditor's Report and Related Financial Statements*; *Audit Considerations When Client Evidence and Corroborating Evidence in Support of the Financial Statements Has Been Destroyed by Fire, Flood, or Natural Disaster* and *Considerations When Audit Documentation Has Been Destroyed by Fire, Flood, or Natural Disaster.* The TPAs are available at **www.aicpa.org/members/div/auditstd/Recently_Issued_Technical_Practice_Aids.asp**.

■ The Public Company Accounting Oversight Board (PCAOB) adopted an auditing standard and issued ethics and independence rules addressing tax services, contingent fees and certain related general ethics and independence standards. PCAOB Auditing Standard no. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*, establishes requirements and provides direction for auditors reporting on unresolved material weaknesses. The rules identify circumstances in which providing tax services impairs auditor independence, strengthen the auditor's responsibilities in connection with seeking audit committee preapproval of tax services and lay a foundation for the PCAOB's independence rules. The standard and rules will not take effect unless the SEC approves them (**www.pcaobus.org/rules/rulemaking_docket.aspx**).

■ The AICPA issued Practice Alert 2005-1, *Auditing Procedures With Respect to Variable Interest Entities*, which provides guidance to auditors of nonissuers and their firms on planning and performing auditing procedures with respect to variable interest entities. The alert is available at **www.aicpa.org/download/auditstd/pract_alert/pa_2005_1.pdf**.

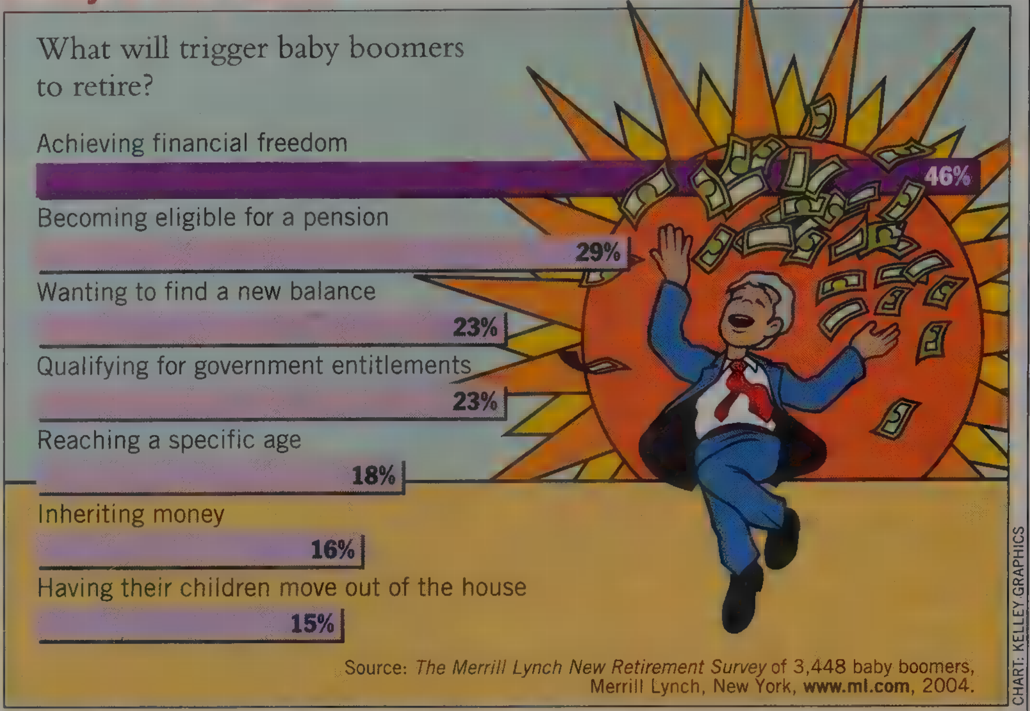
COMPLIANCE

■ The Office of Management and Budget (OMB) issued the Circular A-133 2005 Compliance Supplement (**www.whitehouse.gov/omb/financial/2005_compliance_supp.html**), which is not a complete reissuance of the 2004 edition. The circular governs audits of entities that receive federal funds. The 2005 supplement addresses only new or significantly changed information on agency program requirements and clusters of programs. For 2005 planning and review purposes, therefore, auditors should use both the 2004 and 2005 supplements. The AICPA audit and accounting guide, *Government Auditing Standards and Circular A-133 Audits* (# 012745JA), is available at **www.cpa2biz.com**.

EMPLOYEE BENEFITS

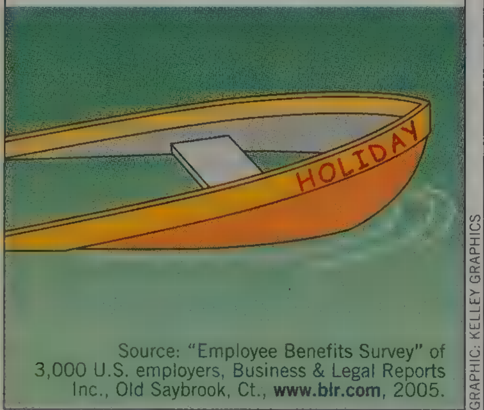
■ The Institute and the Department of Labor's Employee Benefit Security Administration (EBSA) are conducting

Money Is the Measure



A Thing of the Past?

The percentage of employers no longer offering floating holidays is expected to rise to 66% this year from 51% in 2003.



Source: "Employee Benefits Survey" of 3,000 U.S. employers, Business & Legal Reports Inc., Old Saybrook, Ct., **www.blr.com**, 2005.

seminars with state CPA societies for small business clients on how to establish and administer pension, health and other employee benefit plans. Ian MacKay, director of the AICPA Employee Benefit Plan Audit Quality Center (**http://ebpaqc.aicpa.org**), said, "Since most companies don't offer pensions, it's essential to educate them on how to set up benefit plans and help their employees participate in them. As trusted business advisers, CPAs are ideally qualified to guide businesses in such efforts." For information, e-mail educationcampaign seminars@dol.gov.

FINANCIAL REPORTING

■ The SEC invited mutual funds to join other registrants already voluntarily submitting their filings electronically in extensible business reporting language (XBRL) format (**www.sec.gov/spotlight/xbrl.htm**). The commission will assess registrants' ability to properly tag their data in XBRL and will weigh the benefits of tagged data. Information on XBRL is available at **www.xbrl.org**.

GOVERNMENT ACCOUNTING

■ The Governmental Accounting Standards Board's (GASB) new *Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits* can help preparers and auditors implement recent GASB standards on accounting and reporting for health care and other nonpension benefits provided to retirees. To order the guide (# GQA43/45), go to **http://store.yahoo.com/gasbpubs/gqa43-45.html** or call 800-748-0659.

■ The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards (SFFAS) 30, *Inter-Entity Cost Implementation: Amending SFFAS 4*, Managerial Cost Accounting Standards and Concepts (**www.fasab.gov/pdffiles/sffas30aug2005.pdf**; see Official Releases, page 108). SFFAS 30 requires full implementation of the interentity cost provision in SFFAS 4 for reporting periods beginning after September 30, 2008.

■ A revised audit program the Department of Agriculture's Office of Inspector General (OIG) issued in September 2004 is effective for periods ending on or after December 31, 2005 (**www.usda.gov/oig/webdocs/FINALAUDPROG050414.pdf**). In response to OIG concerns about potential fraud, the guidance introduces audit procedures designed to detect any diversion of project funds in the department's Rural Rental Housing program.

INTERNAL CONTROLS

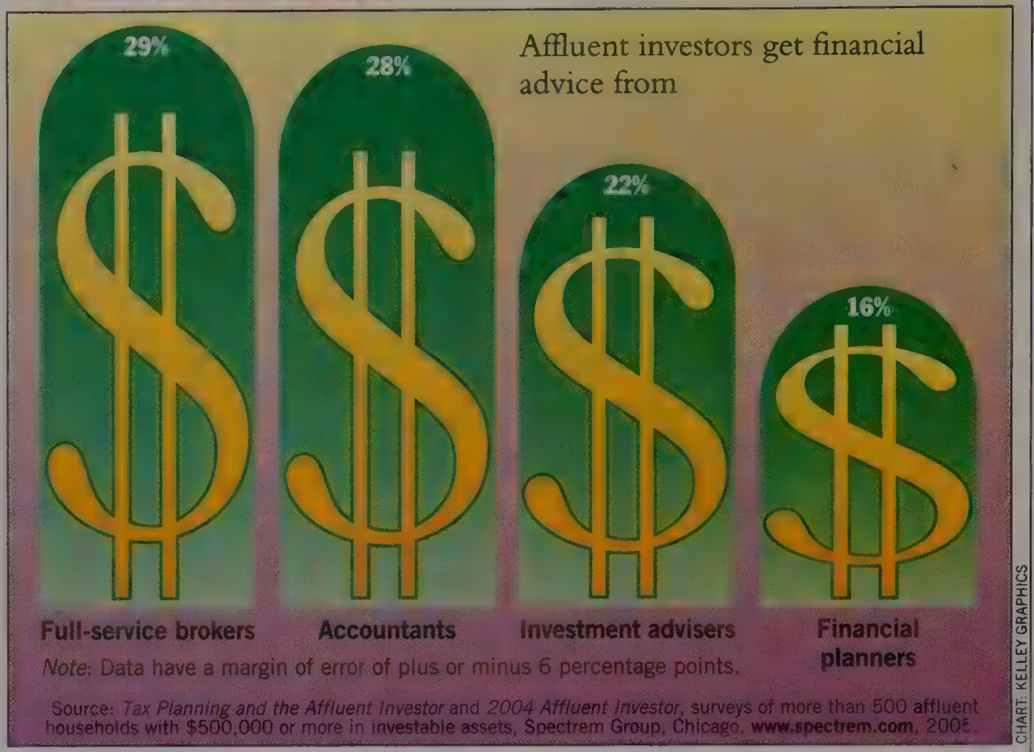
■ The AICPA Audit Committee Effectiveness Center issued "SOX Sec-

tion 404: Responding to an Adverse Report—A Checklist for the Audit Committee," which can be downloaded free at **www.aicpa.org/audcommctr/spotlight/SOX_Section_404.htm**. The checklist provides an overview of the Sarbanes-Oxley Act's internal control evaluation requirements and specifies actions audit committees should take in response to adverse reports.

INTERNATIONAL

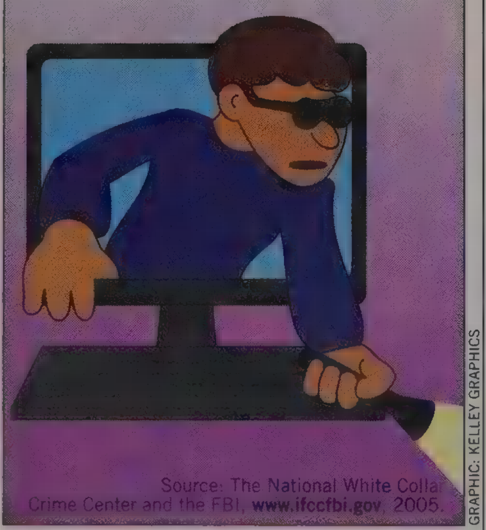
■ The International Accounting Standards Board (IASB) issued one standard and amended three others (**www.iasb.org**). International Financial Reporting Standard (IFRS) 7, *Financial Instruments: Disclosures*, introduces requirements to improve information on financial instruments in entities' financial statements, replacing International Accounting Standard (IAS) 30, *Disclosures in the Financial Statements of Banks and Similar Institutions*, and some of the requirements in IAS 32, *Financial Instruments: Disclosure and Presentation*. A complementary issuance, Amendment to IAS 1, *Presentation of Financial Statements*—Capital Disclosures, introduces requirements for disclosures about an entity's capital. Limited amendments to IAS 39, *Financial Instruments: Recognition and Measurement*, and IFRS 4, *Insurance Contracts*, are intended to ensure issuers of financial guarantee contracts include related liabilities in their balance sheets.

In Whom the Rich Invests



E-Fraud More Than Doubles

Consumers filed 66.6% more complaints about online fraud in 2004 than in 2003 (207,449 vs. 124,509).



■ The International Federation of Accountants' (IFAC) new *International Guidance Document on Environmental Management Accounting* provides a framework and definitions for public accountants and auditors tracking or verifying environmental information in financial and other reports (**www.ifac.org/store**). IFAC also issued *Request for Proposal: Development of a Guide to International Standards on Auditing for Use in Audits of Small- and Medium-sized Entities*, which solicits assistance in developing implementation guidance (**www.ifac.org/taskforces/smpptf.php**). Comments are due November 18, 2005.

MONEY LAUNDERING

■ The Treasury Department's Financial Crimes Enforcement Network released two sets of questions and answers on completing Form 104, *Currency Transaction Report* (**www.fincen.gov/faq08122005.pdf**), and on the applicability of Bank Secrecy Act requirements to new accounts opened by people displaced by Hurricane Katrina (**www.fincen.gov/faqkatrinalead.pdf**).

PROFESSIONAL ISSUES

■ A white paper prepared by the AICPA's Business and Industry Executive Committee reported that CPAs' skills and values are well-suited to meet new demands facing chief financial officers. *CPAs as CFOs: Why You Should Have a CPA in Your C-Suite* says CPAs are particularly qualified to manage the unprecedented operational, financial and compliance risks of today's global business environment. It's available free at the AICPA's newly launched Financial Management Center (**http://fmcenter.aicpa.org**).

■ Also available at the center are the results of the AICPA's June 2005 Business and Industry Economic Outlook Survey, which found that fewer CPAs in senior finance positions were optimistic about the U.S. economy than six months earlier. Still, the great majority of respondents were hopeful about their own organizations' prospects.

■ In response to its governing council's authorizing an effort to educate members and elicit their comments on achieving greater transparency of peer review results, the Institute has gathered member feedback directly and

through state societies, town hall meetings, a dedicated Web site (**www.aicpa.org/transparency/index.htm**) and an online poll. A status report on these activities is available at **www.aicpa.org/transparency/pr_update_7_05.htm**.

■ The AICPA reported that 54,000 accounting majors graduated in 2004, up 19% from 2000. Enrollments in accounting programs also are up 19% for the four-year period. According to the 2005 edition of the Institute's annual study, *The Supply of Accounting Graduates and the Demand for Public Accounting Recruits*, firms of all sizes are projecting double-digit percentage increases in their hiring of new accounting graduates through 2009. The report is available free at **http://ceae.aicpa.org**.

■ A joint task force of the AICPA, the National Association of State Boards of Accountancy and Thomson Prometric Inc. reported the results of its research into why enrollment for the CPA exam declined to 52,000 in the first year of computerized testing from 82,000 the year before. According to the CBT Volume Task Force report, candidates, employees and employers continued to value the CPA credential highly; candidates and employers also said the conversion to a computerized test was an improvement and exam fees were not an obstacle. Candidates most frequently cited work and family commitments as reasons for not taking the exam; they also said they felt no pressure from employers to take it and, because the test is offered on demand, procrastinated in scheduling it. The report recommended ways employers, exam course providers and state societies can help induce more candidates to sit for the exam. It's available at **www.cpa-exam.org/download/volumetaskforcerept605.pdf**.

FYI

■ The Institute launched the AICPA Tax Center (**www.aicpa.org/tax**), offering news related to taxation, information on tax professional standards and the Institute's tax advocacy activities, and access to premium resources, including *The Tax Adviser* magazine, tax practice guides and checklists, and discussion forums focused on specific aspects of taxation.

■ Christopher Cox became chairman of the SEC in August, replacing William H. Donaldson. SEC Chief Accountant Donald T. Nicolaisen resigned in October to return to the private sector, and PCAOB Chairman William J. McDonough said he will step down by the end of November. Their successors had not yet been identified as the *JofA* went to press.

■ The SEC's Division of Corporation Finance chose Andrew J. McLelland, CPA and assistant professor at Auburn


Whoever coined the phrase 'one thing at a time' never ran a small business. Because you do more, we deliver more.
For all your communications, we have everything your small business needs. Simplified products and services working together to keep you working smarter. Because we know how you work, we know how to help you work. Voice, Broadband Internet, Yellow Pages and Cingular Wireless®—now together in place. SBC. GOING THE CALL.®
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University, for a one-year term as its academic accounting fellow. He will interpret research, assist in rule making and act as a liaison with professional standard-setting entities.

■ The AICPA added the brochures and speeches, "College Planning: Easing the Financial Burden" and "Securing Your Business Financing," to its CPA Marketing Tool Kit (**www.aicpa.org/cpamarketing**). The tool kit is designed to help members better market their services through presentations and printed materials for local business and community groups.

■ The IRS and the Department of the Treasury released their 2005–2006 Priority Guidance Plan, which lists the tax issues on which they will issue formal legal guidance next year (**www.irs.gov/pub/irs-utl/2005-2006_guidance_priority_list.pdf**). It reflects suggestions from taxpayers, tax practitioners and industry groups and contains 254 projects dealing with tax topics that affect individuals, corporations, charities, international transactions and employee benefit plans. For copies, call the Treasury's Office of Public Affairs at 202-622-2960.

■ The Treasury Department's Office of Technical Assistance is seeking used journals, magazines and books on public finance, budgeting and financial analysis for its training activities in developing nations. For more information or to make a donation, contact Thomas Glen at tglen@ota.treas.gov or 202-622-5817.

■ Ernst & Young released *IFRS/U.S. GAAP Comparison*, an analysis of the two canons' provisions. The volume, published by the International Accounting Standards Committee Foundation—parent of the International Accounting Standards Board—and LexisNexis Butterworths, can be ordered at **www.ey.com/global/content.nsf/uk/fr_-_gaap_comparisons**.

■ The *JofA* earned honors in the 2005 International Federation of Accountants' Articles of Merit competition. "Enterprising Views of Risk Management" by Russ Banham (*JofA*, Jun.04, page 65; **www.aicpa.org/pubs/jofa/jun2004/banham.htm**) was cited for its distinguished contribution to management accounting. The winning entries can be downloaded free at **www.ifac.org/store**. ■

Correction

Our apologies to Linda Bergen, CPA and author of "Making Flextime Work" in the September 2005 special section on staffing issues (page 96), for spelling her name incorrectly. Ms. Bergen wrote an excellent article and we regret the mistake.

ProSeries announces the cure for one-size-fits-all tax software.

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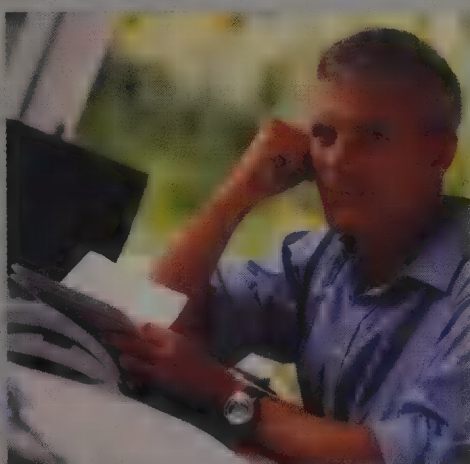

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New clients. New challenges. New goals. ProSeries Basic Edition fits your needs perfectly. It's designed for smaller practices that prepare 1040s and state individual returns — and want expert guidance throughout the tax preparation process. Plus, ProSeries Basic lets you e-file an unlimited number of returns, and easily access live help if you need it. Call toll-free for more information, or to order your free evaluation kit. Even more good news: all this professional-strength tax preparation power starts at **just $250**.

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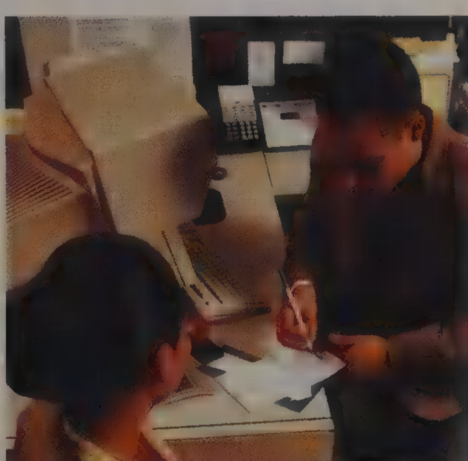

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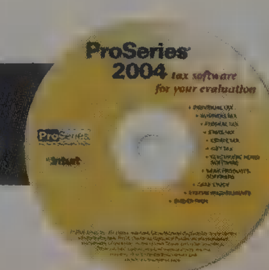

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DVD/VHS — Ideal for on-site staff training or individual self-study

2005 Corporate Tax Returns Videocourse
Sidney Kess leads a team of tax authorities in reviewing major tax developments affecting 1120 and 1120S return preparation for 2005 and provides planning strategies.

No. 112616 (150-min. DVD/Text/Manual); No. 112617 (150-min. VHS/Text/Manual)
Recommended CPE credit (based on a 50-min. hour): 20 Level: Update
Prerequisite: Knowledge of corporate income taxation and Forms 1120 and 1120S preparation
DVD/Text/Manual, $209.00 member/$261.25 nonmember
VHS/Text/Manual, $239.00 member/$296.75 nonmember

2005 Individual Tax Returns Videocourse
Sid Kess and team review major tax developments affecting 1040 return preparation for 2005 and provide planning strategies.

No. 113606 (150-min. DVD/Text/Manual); No. 113607 (150-min. VHS/Text/Manual)
Recommended CPE credit (based on a 50-min. hour): 24 Level: Update
Prerequisite: Knowledge of individual income taxation and Form 1040 preparation
DVD/Text/Manual, $239.00 member/$298.75 nonmember
VHS/Text/Manual, $269.00 member/$336.25 nonmember

Publications...

Compilation and Review Audit Risk Alert, 2005/2006
Updates on recent practice issues and professional standards affecting these engagements.

No. 022306, 2005 Paperback
$30.00 member/$37.50 nonmember

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The 2005 AICPA Fall/Winter Conference Planner is available — please visit www.cpa2biz.com/conferences to plan out your CPE!

AICPA/ASA National Business Valuation Conference
11/14/2005 – 11/16/2005 ▪ Las Vegas, NV

AICPA National Healthcare Industry Conference
11/17/2005 – 11/18/2005 ▪ Las Vegas, NV

AICPA Not-For-Profit Financial Executive Forum
11/17/2005 – 11/18/2005 ▪ San Francisco, CA

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CFO Quarterly Roundtable Series 2005 — 4th Quarter
11/16/05 ▪ 1–3 pm ET ▪ Recommended CPE: 2 credits

Year-End Audit Risk Alert — 2005/2006
11/17/05 ▪ 1–3 pm ET ▪ Recommended CPE: 2 credits

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What CPAs are Buying Now

AICPA's Federal Tax Update, 2005–2006
By Andy Biebl and Robert Ranweiler
No. 731134
Recommended CPE credit (based on a 50-min. hour): 16
Level: Update Format: Text
$145.00 member/$181.25 nonmember

AICPA's Corporate Income Tax Returns Workshop, 2005
By Kess, Biebl and Ranweiler
No. 735210
Recommended CPE credit (based on a 50-min. hour): 16
Level: Update Format: Text
$145.00 member/$181.25 nonmember

Tax Research Techniques, Seventh Edition
No. 061071
$55.00 member/$68.75 nonmember

AICPA's Individual Income Tax Returns Workshop, 2005
By Kess, Biebl and Ranweiler
No. 735220
Recommended CPE credit (based on a 50-min. hour): 20
Level: Update Format: Text
$165.00 member/$186.25 nonmember

AICPA Technical Practice Aids
No. 005145
$115.00 member/$143.75 nonmember

AICPA's Tax Update for Controllers, 2005–2006
No. 732507
Recommended CPE credit (based on a 50-min. hour): 16
Level: Update Format: Text
$155.00 member/$193.75 nonmember

The Adviser's Guide to Health Savings Accounts
No. 091020
$49.00 member/$61.25 nonmember

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NEW & NOTEWORTHY

Not-for-Profits Get New Edition of *Accounting Trends & Techniques*

Fresh views on financial statement reporting and disclosure practices in new publication

Special for the *Journal of Accountancy*

The AICPA has released a new edition of *Accounting Trends & Techniques — Not-for-Profit Organizations* (product No. 006616, www.cpa2biz.com), part of a series of such publications which for over 55 years has provided CPAs with commentary, illustrations and example financial statement disclosures.

The publication provides illustrative financial statements and related disclosures for non-governmental not-for-profit organizations, other than healthcare providers. The examples have been adapted from actual examples of audited financial statements of not-for-profit organizations whose names and other identifying information have been changed.

Organized to be used as a reference tool, it provides practitioners with practical, though non-authoritative, guidance on nonprofits' financial statements and disclosures. CPAs will find sample financial statements like these:

- Statements of Financial Position
- Statements of Activity, Including Changes in Net Assets
- Statements of Cash Flows
- Statements of Functional Expenses

And note disclosures:

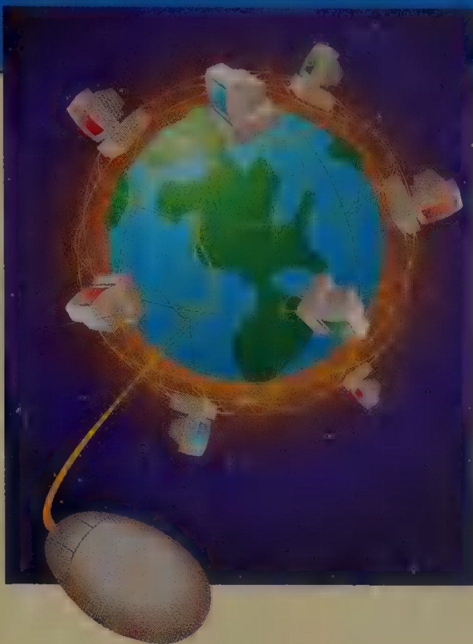
- Disclosures — General (includes examples of descriptions of organizations and general accounting policies, contingencies and other uncertainties, including going concern questions, related parties, use of estimates, comparative prior period information, foreign operations, accounting changes and sample management statement of responsibility)
- Disclosures Related Primarily to the Statement of Financial Position (includes examples of investments, contributions receivable, other receivables, inventory and prepaid expenses, collections, fixed assets, liabilities and net assets)
- Disclosures Related Primarily to the Statement of Activity and Related Statements (includes examples of measure of operations, contributions received, including government grants, earned income and deferred revenue and expenses)

With additional information, such as:

- Financial Statements Prepared on a Basis Other Than GAAP (includes cash or modified cash basis)
- Information Outside the Financial Statements (includes examples of program-focused information, statistical highlights and year-end highlights)

Also included in the publication are appendixes A through E, which include excerpts from SFAS No. 117, SFAS No. 116, the AICPA Audit and Accounting Guide Not-for-Profit Organizations, SFAS No. 136 and SFAS No. 124.

SMART STOPS ON THE WEB



BUSINESS VALUATION SITES

Springboard for Searches
www.business.com
In addition to listing the most popular user searches and an option to download a free version of its toolbar, this search engine and business directory provides news stories by industry—financial services, human resources and small business, for example. Visitors also can find job opportunities through a link to Work.com, and CPA/ABVs will find many valuation resources here. A search of the words *business valuation* yielded more than 200 results, including the following:

■ **www.bulletproofbizplans.com**
Free registration leads users to a brochure for this company's valuation services that has brief case studies on how e-commerce data providers and technology developers implemented business strategies. Visitors can read a sample business plan including a financial snapshot of projected earnings and purchase BV software.

■ **www.business-valuations.biz**
CPA/ABVs can find help in valuing a business by choosing various options from a pull-down menu to get tips tailored to their individual scenario. Users can read frequently asked questions on business appraisal and valuation services, get this company's methodology for selling a business, or sign up for access to a business valuation calculator.

■ **www.bizbuysell.com/guide/sellval.htm**
Business valuators looking for resources will find them here with articles including "Valuation Rules of Thumb" and "Choosing an Appraiser." Users can find links to information on BV methods, estimating a fair price and valuing a business for sale in the Elsewhere on the Web section.

■ **www.trugmanvaluation.com**
CPA/ABVs Gary and Linda Trugman offer visitors to their site recent issues of the *Valuation Trends* newsletter, featuring the latest court decisions on cases involving buy-sell agreements, enterprise vs. personal goodwill and IPOs. For more information users can order Mr. Trugman's book, *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Sized Businesses* (AICPA, hardcover, # 056600JA, **www.cpa2biz.com**).

GENERAL INTEREST SITES

Don't Rock the Boat
www.johnglenncrp.0catch.com
CPA firm owners and HR managers can get information on business continuity, disaster recovery and emergency management plans at John Glenn's e-stop. The archives of articles on contingency planning include the titles "Approaches to a Common Goal" and "Mitigating a Negative Concept." Other links take users to presentations on business continuity ethics and other topics.

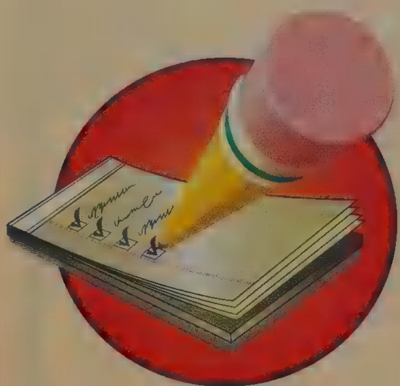
HR = Heavy Resources
www.workforce.com
Business owners and human resources managers can register here for free to open all channels of this Web site about managing your workforce. The site is loaded with articles, surveys and worksheets on benefits, business trends, legal issues, staffing and technology. Need to know how to assess informal workplace learning or defuse morale breakdown? Read the Dear Workforce column for advice. Users also can find case studies and webcasts or look into subscribing to *Workforce Management* magazine.

Expect the Unexpected
www.disaster-recovery-guide.com
Here CPAs can find all of the resources they need to continue normal firm operations in the event of a disaster. Users can sign up for the free *Business Continuity Planner* newsletter, read true stories on disaster recovery, find sample copies of company floor plans to emulate for their own office space, and download documentation to help organize emergency services and staff contact numbers. Visitors also can become members of the disaster recovery planning discussion forum at **http://groups.yahoo.com/group/disaster-recovery-guide**.

LLC 101
www.llc-explained.com
CPAs trying to find information on limited liability companies can read a detailed overview of the topic here, including the free report *The Windfall Profits Paradox* on building long-term business wealth. There are tips on how to secure a loan, manage your time or set up the best possible trade-show displays and links to resources on incorporation services for offshore businesses.

Excellent E-Lookups
www.infoplease.com
Almanacs, atlases and encyclopedias, oh, my! Users can find them all here—along with dictionaries, thesauruses and telephone books at this e-reference desk. The home page features This Day in History, Today's News and What Does It Mean? sections. There's a glossary of financial terms, and CPAs can find financial calculators for budgeting and saving, home mortgages, insurance, mutual funds, retirement, Roth IRAs and stocks and bonds. The Business and Finance section lists the top NYSE stocks by dollar value and the link to **http://infoplease.4jobs.com** unlocks channels for users to search industry-specific jobs.

Audits That Keep Fraudsters Guessing



Scratch the surface of many audit plans and you'll find predictable elements that someone bent on fraud can anticipate and foil. That's why SAS no. 99, *Consideration of Fraud in a Financial Statement Audit*, requires auditors to incorporate elements of unpredictability into their procedures. Here's how.

❑ ***Use random sampling.*** Auditing a patternless selection of items makes it impossible for fraudsters to determine which will be chosen.

❑ ***Conduct surprise visits.*** Showing up unannounced to count inventory prevents employees from fraudulently moving goods from one location to another just to fool auditors.

❑ ***Change the timing.*** At clients where accounts receivable traditionally are confirmed at fiscal year-end, try performing this audit procedure two months early.

❑ ***Vary your technique each year.*** If you've always tested a sample of transactions posted to an account, switch to an analytical test that compares account activity with production data. That might make fraud easier to spot.

❑ ***Evaluate low-profile accounts.*** Selecting accounts that are not normally audited might reveal items being hidden in them for just that reason.

❑ ***Test small accounts.*** Checking them could reveal fraudulent transactions spread over several accounts of relatively insignificant size.

❑ ***Look for bogus patterns.*** Use Benford's Law, a statistical formula for evaluating the frequency of given values in a random sample, to expose implausible numeric data. (See "I've Got Your Number," *JofA*, May99, page 79, **www.aicpa.org/pubs/jofa/may1999/nigrini.htm**.)

❑ ***Observe operations discreetly.*** Monitoring customer traffic or vendor deliveries from a nearby vantage point may reveal discrepancies in recorded revenue.

❑ ***Review whistleblower files.*** Look over employee reports of company mal- or misfeasance for indications of fraud.

❑ ***Use audit software.*** Test large electronic transaction files for duplicate payments, invoices or addresses for multiple employees or vendors that often escape notice when checked manually.

❑ ***Get a clearer view of the numbers.*** Use graphs to display daily, weekly or monthly data—such as the number and dollar amount of transactions or journal entries—on key cycles or processes to make it easier to spot abnormal amounts and address the risk of management override.

❑ ***Embed software monitors.*** Get the client's permission to design and plant a program to capture, encrypt and record key data for auditors to analyze later.

❑ ***Check the Web.*** Visit Internet chat groups in which employees who own the client's stock discuss operational or other issues that might merit consideration as part of an effective audit.

❑ ***Use alternative models.*** Develop independent evaluation models and assumptions, instead of using those supplied by management, to verify clients' estimates of warranty costs and other charges.

Editor's note: SAS no. 99 (product no. 060701JA) can be ordered at **www.cpa2biz.com**.

Source: Thomas E. McKee, CPA, professor of accountancy at East Tennessee State University's College of Business and Technology, Johnson City (e-mail temckee@ etsu.edu).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PRIORITY MAIL
Order a free Carrier Pickup™ at usps.com/pickup for all your Priority Mail® and Express Mail® packages. We'll pick up all your postage-paid packages the next delivery day. It's easy. And it's free. No matter how many packages you send. Order carryout from the U.S. Postal Service® and go out to lunch for a change.
UNITED STATES POSTAL SERVICE
usps.com

Referral sources are the key to building business in this fast-growing specialty.

Get Your BV Niche Out There

BY BARBARA WALTERS PRICE

Business valuation (BV) is a fast-growing niche with a unique marketing challenge. Valuators such as CPA/ABVs assist in mostly one-time engagements—expert witness and litigation services, estate and gift tax compliance, business purchases and sales, goodwill impairment analyses or intellectual property valuations. That makes marketing them different from marketing traditional tax and compliance work. To build this unique niche here's what you can do to make the phone ring—again and again—with real prospects.

Growth Area

A survey of 70 top 100 firms showed 89% planned to increase business valuation services.

Source: *Accounting Today.*

IDENTIFY YOUR INDUSTRY STRENGTHS

Almost every practice develops an industry specialization over time. You can use yours to increase your BV marketing effectiveness. The first step is to determine your firm's industry specialty (such as construction, restaurants or retail). List current and past clients and the industries in which they operate and note the client-base concentrations that distinguish your firm from the competition. That's where you can demonstrate expertise to referral sources. Write a simple statement about how your firm's service is special—then use it as the basis of your campaign. Marketing should address the audience where you have depth of knowledge.

"Prospects want to know you understand their business," says Donna Erbs, marketing director of Anders, Minkler and Diehl LLP in St. Louis.

Presenting your firm as an industry specialist doesn't close the door to other types of BV engagements, either. On the contrary, industry specialization expands your efforts to those outside the specialty, some of whom will see the firm as a valuation resource first.

PINPOINT YOUR MARKET

Because the ultimate user of a valuation typically relies on a professional's advice about whom to engage, referral sources are a BV practice's lifeblood. Thus the individual who will recommend your firm, rather than any particular client, is the important party to reach. A "referral source becomes your annuity," says

Begin With the Basics

A CPA designation alone is not enough to make you a credible provider of BV services. You need technical training and specific valuation credentials. The AICPA offers the ABV (Accredited in Business Valuation) designation. For requirements go to **www.aicpa.org/BVFLS** and see "Resources," page 43, for more information.

Ed Morris, CPA, of CDH Valuation Services LLC in Itasca, Ill., and your goal is to locate the right ones for your firm's technical strengths.

To build a BV practice, your firm needs to market to appropriate sources such as

- For *calculation of business damages*: litigation attorneys, corporate attorneys and insurance companies.
- For *divorce*: divorce attorneys and mediators.
- For *employee stock ownership plans*: business owners, CPAs and trust officers.
- For *estate and gift tax compliance*: trust and estate attorneys, tax attorneys, trust officers, insurance advisers and investment advisers.
- For *goodwill impairment analysis*: CPAs and CFOs.
- For *intellectual property valuation*: CPAs, CFOs and corporate attorneys.
- For *purchase or sale of a business*: business owners.

Face-to-face contact [redacted] the [redacted] powerful tool [redacted] your disposal, says [redacted] Harold Martin, partner-in-charge [redacted] for Keiter, Stephens, Hurst, Gary and Shreaves.

PHOTOGRAPH BY JAY PAUL/BLACK STAR

TARGET YOUR SOURCES

Targeted marketing helps you woo BV referral sources efficiently. Identify your best, second-best and third-tier prospects and rate them A, B and C. A-tier sources likely are few in number, but they will be the best source of interesting, profitable engagements. You seek top-of-mind awareness with those who can refer business to you, so make your contact with the A group highly individualized and frequent. Find reasons to meet with them face to face. Referral sources in the B tier, which have the potential to become A's with relatively little effort, call for an individual approach, too. Focus on moving them to the A-list.

Face-to-face contact is the most powerful tool at your disposal, says CPA/ABV Harold Martin, partner-in-charge of BV and litigation services for Keiter, Stephens, Hurst, Gary and Shreaves PC in Glen Allen, Va. "Referral sources and prospects have to trust you, and that's only going to happen face to face," agrees Morris.

Having breakfast or lunch with a referral source, taking in a ballgame together or just dropping by an A or B source's office to say hello are simple, powerful networking activities. You also can hand-deliver a service proposal or even a final invoice, attend trade association meetings, ask a referral source to be a cospeaker or a coauthor with you, and conduct quarterly "how's business?" meetings where you discuss *their* business challenges and opportunities.

Referral sources in the C tier are the most plentiful. Although they certainly are valued, too, the most effective marketing to this group is by informing them of what your firm is doing in the BV area in newsletters, monthly calls and on your Web site.

CROSS-SELL WITHIN YOUR FIRM

Independence rules prohibit CPA firms from performing BV services for attest clients, but you can provide BV services to nonattest clients within your firm. Such cross-selling is akin to picking low-hanging fruit. It helps to make sure all partners understand the nature and benefits of your

Spend *at least* 2% of your firm's gross revenue on marketing activities and plan to increase that to 3% to 5% (or more) over time.

firm's valuation services. "Monthly marketing meetings are a great communications tool," says Barbara Oswalt, CPA/ABV, a partner with Hoyman, Dobson and Co. PA in Melbourne, Fla., who uses monthly team meetings to update partners on the activities and services of other areas of the firm. Martin swears by monthly marketing meetings and in-house seminars, too. "We constantly reinforce things our peers should be looking for," he says.

MAKE A PLAN AND A BUDGET

Marketing plans don't require detailed manuals, so keep yours simple. Before you add a strategy or action to the plan, ask yourself, "Will this ultimately make the phone ring?" Pare your program down to crystal-clear, actionable goals, such as "I will have lunch with two current or potential referral sources every week." Make different marketing plans for your A- B- and C-lists.

You have to invest in the marketing effort, and that means budgeting for it. There are two possible approaches here. You can forecast expected future revenues and then set your marketing and business development budget to support activities that will help you attain your goals. Or set your marketing objectives and then determine the cost to reach them, giving priority to the activities that produce the highest return on investment.

In either case, spend *at least* 2% of your firm's gross revenue on marketing activities and plan to increase that to 3% to 5% (or more) over time.

TOOLS OF THE TRADE

Besides the all important face-to-face networking, there are other tools you can use to attract BV clients. Not every tool mentioned below is right for every firm or professional. Choose those that will work best for you.

Newsletters. It is vital to communicate *regularly* with all segments of your referral base. Whether delivered in print or by e-mail, newsletters disseminate information about your firm and the profession and help establish credibility. You can have a business valuation newsletter separate from your firm's general corporate newsletter or incorporate BV content into it. Firms that market to an industry niche typically have industry-specific newsletters with BV content.

If creating customized content for a newsletter is not possible for your firm, you can purchase "canned" BV newsletters that are personalized with your firm's logo and contact information. Practice Development Institute offers eight valuation and/or litigation support newsletters in both print and electronic formats (**www.pdiglobal.com**). Valuation Information Inc. offers three print newsletters (**www.valuationinformation.com**). You also can send e-mail notices to your referral base of gift and estate attorneys when a new tax court case of interest is announced or even e-mail them articles and columns from the *JofA* or other publications.

Web sites. Your firm's Web site is more than an electronic billboard. It's an important and often overlooked business-generation tool. Bob Grossman, CPA/ABV, a

EXECUTIVE SUMMARY

- **CPAs WHO SEEK TO DEVELOP A BV NICHE** should first determine the areas in which the firm can demonstrate expertise to referral sources. Prospects want to know that a firm understands their business. CPAs need technical training and specific valuation credentials to become credible providers of BV services.

- **CLIENTS SEEKING A VALUATION** typically rely on professional advice about whom to engage. That makes the individual who will recommend the firm the important party to reach, rather than any particular client. CPA/ABVs should organize referral sources into A-, B-, and C-lists. Face-to-face contact with A-list sources is the most powerful marketing tool.

- **INDEPENDENCE RULES PROHIBIT CPAs** from performing BV services for attest clients, but nonattest clients provide opportunities. CPAs should make sure all partners understand and help market the firm's BV practice.

- **A WEB SITE IS OFTEN THE FIRST CONTACT** with potential referral sources and clients. All information on the Web site should be current. A user-friendly subscription mechanism and format help.

- **TRAINING PEERS BUILDS CREDIBILITY.** CPA/ABVs should try to speak at valuation conferences and seminars and write articles for publication. Teaching through a professional association or at local colleges helps practitioners stay current.

- **CPA/ABVs BENEFIT FROM SERVING** on BV association or state society committees. Networking with other BV professionals can lead to cross-selling opportunities. Other networking ideas are conducting BV seminars for referral sources (offering CLE and CPE credit) and sponsoring informal receptions with referral sources.

BARBARA WALTERS PRICE, senior vice president of marketing at Mercer Capital Management, oversees the firm's marketing strategy, including business appraisal product development. Price speaks and writes frequently on valuation topics. Her e-mail address is priceb@mercercapital.com. CPA/ABVs can find practical marketing tips on her blog, BWPrice's Marketing U, **www.bwprice.blogs.com**.

Barbara Oswalt, CPA, a Hoyman, Dobson and Co. partner, invests time in regular monthly team meetings to update partners on the nature and benefits of activities and offerings in other firm areas such as valuation services.

PHOTOGRAPH BY GARY T. TRUMAN/BLACK STAR

partner at Grossman, Yanak and Ford LLP in Pittsburgh, says many BV opportunities come directly from his firm's Web site.

A Web site's strength is its unique ability to use technology to involve readers in different ways. Content and navigation are the keys to an effective Web site. Posting valuable, easily accessed data is an excellent way to interest readers. Keep the copy brief and informative and have a visual format that's easy to understand. Present information in short paragraphs that lead into bulleted copy.

Provide a user-friendly subscription mechanism and post your firm's newsletters, partner speaking-engagement schedules (with related handouts) and articles written by staff. Make sure all information posted to the Web site is current. Successful client case studies are another powerful and underused tool.

A Web site with text and graphics, promotional offers, data and devices to elicit reader response is a form of direct marketing (see "Be a Standout on the Web," *JofA*, Apr.01, page 43). You can use yours to showcase your firm's specialized services. Anders, Minkler and Diehl LLP (**www.amdval.com**) and CDH Valuation Services LLC (**www.cdhvaluations.com**) use a separate site with a distinct Web address specific to their BV practice.

"Your Web site is often the first point of contact between your firm and a potential referral source or client. It's very helpful in the selling process," Martin says. His firm's Web site lists what a client should look for in a business appraiser and describes each BV credential.

Speaking engagements and articles. Never forget that clients and referral sources seek a firm with a reputation for expertise, which is built in large part through speaking engagements and published articles. "Writing and speaking activities let us demonstrate our knowledge and expertise in a particular area and educate the audience in the services we provide," says Tracy Crevar Warren, marketing director of Dixon-Hughes PLLC, in High Point, N.C., and often-published former president of the Association of Accounting Marketers. "In the process, we develop some trust factors that must be present for someone to want to work with us."

Spend the time to consider which venues best reach the audience you prefer. If your firm has industry specializations, look to industry groups, publications, associations and conferences. Neil Beaton, CPA/ABV, Grant Thornton partner in charge of valuation services in Seattle, for example, spoke on the topic of valuation and succession planning at a conference of the National Association of Electrical Distributors

(NAED). "After the speech I got three valuation engagements on the spot, and NAED asked me to speak again on the topic," he says. Although walking away from a speech with an engagement is rare, it isn't unusual for a prospect to contact a firm weeks, months or even years later. Beaton says a client held on to his card and contacted him four years after one talk.

Also offer to speak at business valuation conferences and seminars and present articles for publication in BV journals. Training your peers is a powerful credibility builder.

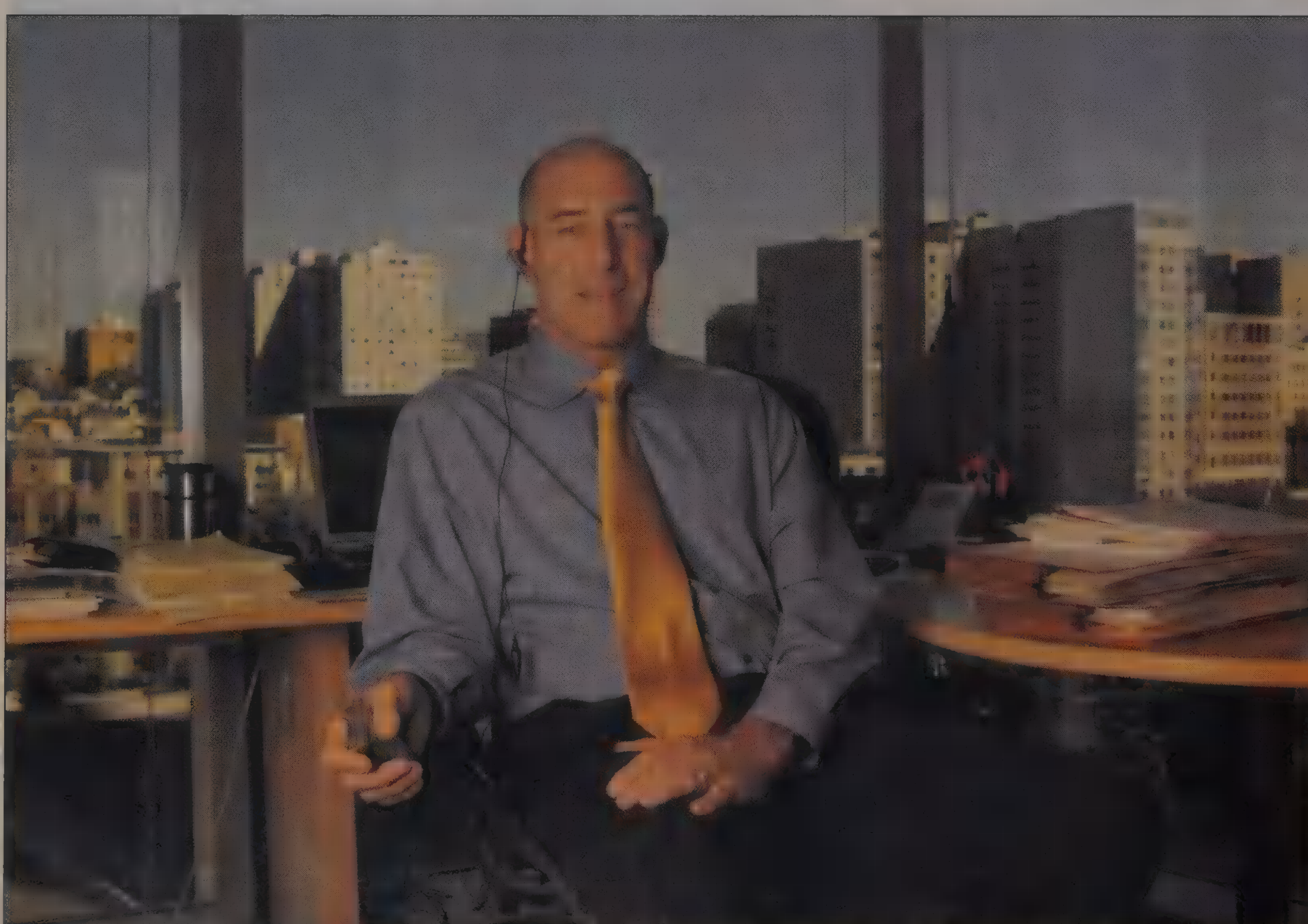
PRACTICAL TIPS

- Focus on potential referral sources, not potential clients.
- Determine what makes your firm's service unique and make that the framework for your marketing.
- Rate your best, second-best and third-tier prospects A, B and C. Make contact with your A-list highly individualized and frequent.
- Communicate *regularly* with all segments of your referral base.

Teaching BV courses. For many professionals, teaching business valuation courses through a professional association or at local colleges or universities is an important part of the marketing mix. Teaching forces you to stay current on all aspects of the discipline, builds professional credibility and is personally rewarding.

Advertising. Advertising is primarily a brand-building activity. Targeted, ongoing advertising demonstrates devotion to an industry and puts your name in front of those who can use your services. While it's unusual to receive a prospect call based on a specific ad, it does happen. But effective advertising is based on frequency. Anders, Minkler and Diehl spreads its advertising dollars over several publications and supplements the ads with articles written by business valuation professionals and press releases. "Whether an ad appears one month or not, it seems as though we are always present in that publication," Erbs says. Target the industry or professional publications your referral sources read, such as legal journals, and be prepared to commit to an advertising strategy for a lengthy period of time before you can expect to see results.

Professional and community networking. Serving on BV committees of your professional associations or state society helps build credibility, gives you a chance to network with other BV professionals and can lead to cross-



Neil Beaton, CPA, Grant Thornton partner for BV in Seattle, gave a talk on valuation and succession planning at a seminar and "got three valuation engagements on the spot." One client held on to his business card and contacted him four years later.

PHOTOGRAPH BY DOUG WILSON/BLACK STAR

selling opportunities. Community involvement in your hometown is another networking tool, as well as a way to give back. Conduct BV seminars for your referral sources and offer CLE and CPE credit (the NASBA Web site, **www.nasba.org**, has a list of frequently asked questions related to CPE). Sponsor receptions with referral sources in an informal setting. A low-budget way to put your name in front of clients and referral sources you know is to send articles about topics that interest them along with a brief note.

Hiring a marketing director. A marketing professional brings a set of skills to the process if your firm is large enough. The larger your practice grows, the less time you will have to devote to marketing your firm. If you do decide to get help, look for someone with experience in professional services, an education in marketing and business development, and an ability to think strategically. A good marketing director will make your firm look like a cohesive organization rather than a collection of individuals and will build brand equity.

WHAT ARE YOU WAITING FOR?

The lure of varied, more interesting and higher-fee engagements brings many practitioners to business valuation. Begin today to set the foundation: Analyze your firm's client base to determine its industry specialty; locate the best referral sources for its technical strengths; and write a simple position statement about what makes your firm's service unique. Use it as the framework for your promotional efforts—your publicity mailings, Web site and advertising—to get your targeted group to think of you first when it needs a business valuation. Ongoing technical training is a prerequisite for technical excellence and helps build a solid reputation, but constant marketing is a prerequisite for practice growth. Marketing makes the phone ring. ■

RESOURCES

AICPA Resources

ABV designation

For information about the AICPA's Accredited in Business Valuation (ABV) designation, go to **www.aicpa.org/BVFLS**, call the ABV Hotline at 212-596-6211 or download the ABV Handbook at **www.aicpa.org/download/abv/abv_handbook.pdf**.

Conferences

The Accounting Firm Marketing Forum
November 10–11, 2005
AICPA Boardroom
New York
(To register call toll-free 866-265-1975; outside the U.S. 201-938-3700.)

AICPA/ASA National Business Valuation Conference
November 14–16, 2005
Bellagio Hotel
Las Vegas

CPE

Successful Strategies for CPA Firms, DVD (# 181831JA);
VHS (#181830JA).

Publications

- AICPA Statement on Standards for Consulting Services no. 1, *Consulting Services: Definitions and Standards,* paperback (# 005104JA); standalone document (# 055015JA).
- *CPAs That Sell: A Complete Guide to Promoting Your Professional Services,* hardback (# 090420JA).
- *How to Hire a Marketing Director and Make It Work,* The Association for Accounting Marketing and AICPA, paperback (# 090415JA).
- *Marketing a Consulting Niche,* paperback (# 056508JA).
- *Mastering the Art of Marketing Professional Services: A Step-by-Step Best Practices Guide*, paperback (# 090474JA).

Web sites

- CPA Marketing Tool Kit, **http://preview2.aicpa.org/cpamarketing**.
- PCPS Firm Practice Center, **http://pcps.aicpa.org**.
- For a list of AICPA committees to join, go to **https://volunteers.aicpa.org/default.aspx**.

For more information, to place an order or to register, go to **www.cpa2biz.com** or call the AICPA at 888-777-7077.

Other Resources

Other accrediting groups

- American Society of Appraisers (ASA), **www.appraisers.org**.
- The Appraisal Foundation, **www.appraisalfoundation.org**.
- Institute of Business Appraisers (IBA), **www.instbusapp.org**.
- National Association of Certified Valuation Analysts (NACVA), **www.nacva.com**.

Recommended reading

- *The Little Red Book of Selling: 12.5 Principles of Sales Greatness* by Jeffrey Gitomer, Bard Press.
- *Never Eat Alone: And Other Secrets to Success, One Relationship at a Time* by Keith Ferrazzi and Tahl Raz, Currency.
- *The Rainmaker's Toolkit: Power Strategies for Finding, Keeping, and Growing Profitable Clients* by Harry Mills, AMACOM.
- *Selling the Invisible* by Harry Beckwith, Warner Business Books.

Web site

www.BVResources.com has a variety of BV resources, including a useful list of "hot links."

Using an income approach to value health care practices gets the best results.

Medical Practices: A BV Rx

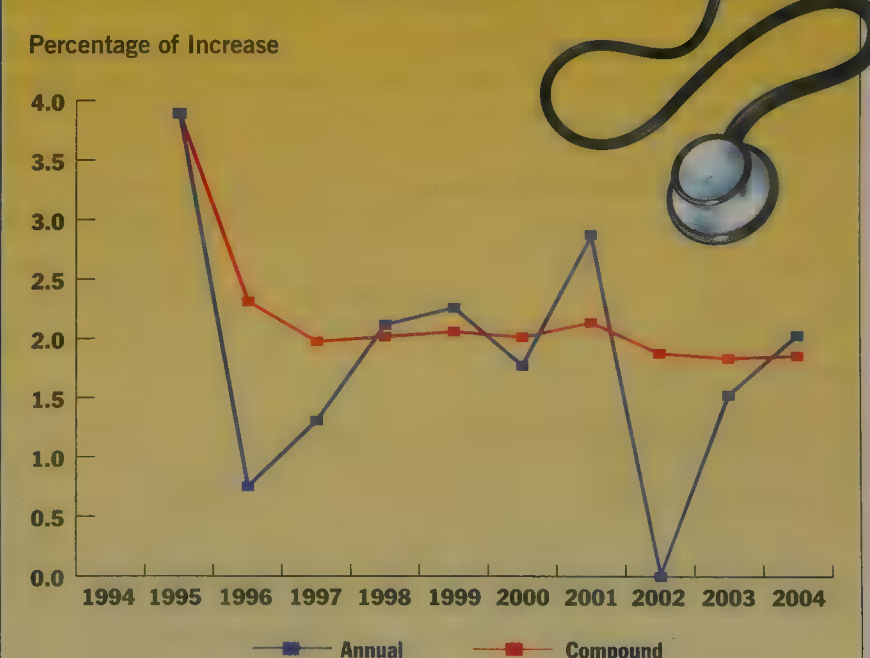
BY MARK O. DIETRICH

Valuing medical practices is full of traps. Byzantine regulations, draconian fines, piecework economics, unit fees that grow at less than the rate of inflation and a heavy reliance on personal goodwill as a key intangible asset are only some of the possible pitfalls for the CPA/ABV or other valuation analyst asked to "prescribe" a price.

Physician clients need business valuations (BV) for diverse reasons: a purchase or sale or to allocate purchase price components for tax or financial reporting purposes or for divorce or other types of litigation. CPA/ABVs considering using the market approach to value health care entities should be aware it yields less meaningful data than the income approach. This article details market-data pitfalls in medical practice valuations and offers guidance on four key aspects of using an income approach to get the best results.

Growth Rate of Service Fees

Over a 10-year period doctors' unit fees for service have gone up at much less than the economy's rate of inflation, with a compound growth rate of only 1.84%.



Source: Bureau of Labor Statistics' Producer Price Index.

FUELED BY FICTION

The physician practice management (PPM) industry boom began in the early 1990s. PPM was a new business model based on consolidating health care systems and physician practices under entrepreneurial management. A great many "roll-up" transactions replaced traditional physician-to-physician transfers of small practice units, and PPM became a large public market segment, with $13 billion in capitalization and more than 30 public companies created and grown by acquisitions. However, by the end of the decade the sector's health had declined dramatically—starved by insuf-

One important aspect of medical-practice cash flow is that buyers of medical practices can't simply pass the acquisition price on to patients.

ficient postacquisition cash flow to support transaction prices. Most valuation analysts who used these transactions as the basis of appraisals derived multiples based on numbers of physicians "acquired" to determine price. CPA/ABVs in the current environment will want to follow a more sustainable valuation model.

One important aspect of medical-practice cash flow is that buyers of medical practices can't simply pass the acquisition price on to patients as, for instance, a restaurant does when a new owner charges customers higher prices or reduces portions. Indeed, most owner-physicians realize the bulk of the net present value of their investment through annual earnings, not from a business sale. CPA/ABVs will find that future cash flow on a stand-alone basis is the appropriate indicator of value for small, privately held medical practices.

WHY MARKET DATA ARE SUSPECT

It's easy to understand why some valuation analysts found a market approach for medical-practice BVs plausible and attractive. Market data draw on actual transactions used in a seemingly meaningful way. Such BVs are easy for clients, taxing authorities, courts and financially unsophisticated jurors to follow. However, the problems outweigh the benefits because

- Market data, even from well-respected sources, can be skewed and thus have limited relevance.
- In some cases, market data from transactions that fail remain in databases long after the fact.
- The IRS and other government authorities are aware that market data in this area are weak, creating risk.

CPA/ABVs should be aware that medical business models complicate the picture, too. Managed care is an important factor, for example (see "Med BV Glossary," page 47). It is prevalent in urban areas, where population density and an abundance of employers make attractive insurance markets. Rural areas have less managed care and fewer patients per square mile, but they may have more unprofitable Medicaid patients. The profitability of a practice per unit of service likely will be better in areas with less managed care and where higher fees and lower operating costs are the norm. This fact greatly limits the usefulness of a "goodwill percentage," since valuation is a function of cash flow from profit, not revenue.

The databases CPA/ABVs can draw on for market information have shortcomings: Regionalization influences market data, for instance. In November 2004 nearly 90% of 96 items identified as general dentistry in the highly detailed, well-respected *Pratt's Stats* BV database were from only three states. One broker submitted 50 of the entries and another submitted 20, which suggests how the views of a few individuals can distort a market. The well-known *Goodwill Registry* cites a range of financial data, "goodwill" value (often not cash equivalent, thus not fair market value), control and noncontrol transactions, valuations not resulting in a transaction and final divorce settlements—which are court decisions. However, some of its data go back to 1988. Even broadly held views of market value, such as the tech-

EXECUTIVE SUMMARY

- **CPA/ABVs NEED TO BE AWARE** that a market-data approach to valuing medical entities is easy to follow but may yield less meaningful data than an income approach.

- **INCOME-APPROACH METHODS** include capitalization of cash flows (CCF) and discounted cash flow (DCF). CPA/ABVs must identify a normalized net cash flow from operations and apply a discount or capitalization rate that reflects associated risk. The purpose is to determine whether future revenue will mirror the past.

- **A CPA/ABV USING THE INCOME APPROACH** must identify what portion of a practice's revenues depend on Medicare, HMOs and other insurers and understand their respective fee restrictions; determine reasonable physician compensation (vis à vis goodwill); determine the correct discount rate based on the relative risk of various physician specialties; and quantify a realistic growth rate.

- **THE ACCEPTED INTERPRETATION** of reasonable compensation under the fair market value standard is the salary necessary to hire a nonowner replacement physician of equal experience. In other words, the CPA/ABV must distinguish between the return on labor and the return on capital or equity.

- **BESIDES KNOWING THE CORRECT QUANTITATIVE** assumptions to use in a valuation model, the CPA/ABV must be familiar with the key regulatory factors: the Stark laws, the Anti-Kickback Statute, the Intermediate Sanctions Provision of the Internal Revenue Code and OIG Special Advisory Bulletin, *Practices of Business Consultants* (June 2001).

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sector consensus preceding the 2000 collapse, may overlook relevant facts.

Government regulations, including the Stark laws and the Anti-Kickback Statute, dictate how some market data can be used. Most of the medical consolidation purchases of the 1990s were in the South and Southwest; yet those market data were used as the basis of calculations throughout the country. In recognition of possible abuses, a second set of Stark II laws, released in 2004, specifically defines "fair market value" as "the price at which bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition." Stark II limits data transferability when the valuation is for regulatory purposes unless the CPA/ABV can demonstrate that data from one region or state relate to another.

INCOME-APPROACH METHODS

So what's a CPA/ABV to do if he or she does not rely on market data multiples as a primary valuation method? The answer is a disciplined application of income-approach methods, including capitalization of cash flows (CCF), discounted cash flow (DCF) and capitalization of excess earnings (CEE), technically a combination of cost and income approaches. When weighted capitalization rates for tangible- and intangible-asset cash flows are used to derive a single capitalization rate for all cash flows, CEE will generate the same result as CCF.

Valuing a medical practice on the basis of income is like valuing any other business: CPA/ABVs must identify a normalized net cash flow from operations and apply a discount or capitalization rate that reflects associated risk. The purpose is to determine whether future revenues will mirror the past. To properly use the income approach, a valuator must do four things:

- Identify what portion of the practice's revenues depends on Medicare, assess how that will affect future cash flow and analyze how the principal HMOs or other health insurers contribute to the practice's revenues.
- Determine what reasonable physician compensation is for the valuation model.
- Understand the relative risk of various physician specialties to determine the correct discount rate.
- Quantify a realistic growth rate in future net cash flow for purposes of building a discounted cash flow (DCF) model and for computing the capitalization rate. *(continued on page 48)*

Med BV Glossary

Here are some business terms that pertain to valuing medical entities:

501(c)(3)—Refers to section 501(c)(3) of the United States Internal Revenue Code of 1954, which deals with nonprofit organizations that are exempt from federal income taxes.

Balanced Budget Act of 1997—This act changed the Medicare reimbursement system for skilled nursing services, home health services and inpatient rehabilitation.

Capitalization of cash flows (CCF)—A BV income approach whereby economic benefits for a representative period are converted to value by dividing by a capitalization rate.

Capitation—Flat, periodic compensation on a per-patient, per-month basis to a health care provider who assumes the risk that the fixed payment will cover treatment costs.

Certificate of need (CON)—A certificate, traditionally issued by a government agency, approving a health care facility's request for a specific service or function.

CHAMPUS (now TRICARE)—The Civilian Health and Medical Program of the Uniformed Services pays for civilian-provider medical care of retired members of the U.S. uniformed services and their related dependents.

Cost-plus reimbursement—Reimbursement compensating a recipient for the costs of providing a service plus an additional fee.

Discounted cash-flow method—A BV income-approach method whereby the present value of future expected net cash flows is calculated using a discount rate.

Fair market value—The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

Free-standing outpatient surgery center (FOSC)—An outpatient surgery facility owned by a hospital but not a physical part of it. FOSCs are not subject to the same cost structures as inpatient surgery centers in hospitals.

Managed care organizations—Organizations that provide management services to corporations and insurers for the reduction or control of health care costs. Health maintenance organizations (HMOs) are in this category.

Medicaid—This federal program founded in 1965 provides health care to indigent persons and individuals with certain diseases. States administer the Medicaid program.

Medicare program—This federal program established in 1965 and administered at the federal level provides health care to individuals 65 years and older and to others entitled to Social Security benefits. Medicare Part A refers to the hospital care portion of the program. Medicare Part B helps those who qualify for Part A with payment for physician services.

Prospective payment system—This Medicare pricing negotiates payment to health care facilities for services—for example, by diagnostic-related groups (DRG) for hospital inpatient services, among others.

Source: Adapted from *Financial Valuation: Applications and Models*, edited by James R. Hitchner, John Wiley & Sons, 2003.

On average, Medicare provided physicians with a 1.5% fee increase in 2005, after legislation overturned a scheduled 4.5% decrease.

Medicare. Many practices (including cardiology, general surgery, oncology and orthopedics) get much of their revenue from the Medicare program, so understanding the impact of Medicare legislation is important to developing an accurate cash-flow forecast. For example, oncology practices, which earn significant income from chemotherapy drugs, were negatively affected when the 2003 Medicare Modernization Act changed the way those drugs are paid for. HMOs trying to reduce costs also are producing a cascading, negative cash-flow effect on future revenue streams.

Medicare's budgeted spending on physician services, unlike any other segment of the health care industry, cannot exceed a predetermined level. On average, Medicare provided physicians with a 1.5% fee increase in 2005, after legislation overturned a scheduled 4.5% decrease based on a statutory formula that sets annual fee changes. Future cuts are estimated at between 3.5% and 5.0% per year, absent further legislation.

The Medicare conversion factor measures fees for each physician procedure or service in relative value units (RVUs). Medicare fees per RVU have increased only 3.3 percentage points in seven years. Adjustments use the Medicare Economic Index (MEI) to analyze increases in physicians' practice costs from inflation and other factors. An annual "update adjustment factor," designed to reflect success or failure in meeting the law's "allowed expenditures" target, is based on a sustainable growth rate.

In physician billing, RVUs are analogous to hours in an accounting firm: the more RVUs performed, the higher the fee. Unlike hourly billing rates, which can vary, the RVU rate usually is fixed. Rather than permit a higher billing rate for more-complex procedures, Medicare assigns a higher number of RVUs, and it assigns RVUs to new procedures as they are developed and implemented. Because spending on physician services can't exceed allowed expenditures, old procedures often are devalued to provide compensation for new ones. Interventional radiology, a relatively new specialty, is one example of such revaluation. The result is a low growth or no growth environment for per unit revenue, which the CPA/ABV needs to factor into the valuation model.

Reasonable compensation and goodwill. Goodwill is a key intangible asset for the typical medical practice, but the importance of separately identifying *personal* goodwill depends on the reason for the valuation. Goodwill ordinarily is determined by a multiple of earnings in excess of a normal or reasonable amount. When necessary, the CPA/ABV can best address valuing personal goodwill by calculating reasonable compensation. Understating reasonable compensation will result in overstating goodwill. If the selling physician(s) still will be employed by the practice after the sale, the cash flow the buyer is purchasing—the subject of the valuation—can't be known without including a realistic amount of postsale compensation in the valuation model.

For example, assume median Medical Group Management Association (MGMA) compensation is $200,000, and 75th percentile compensation is $250,000 (that is, 75% of the MDs make less than $250,000). A physician who earns compensation of $300,000 a year generates revenues in the 75th percentile of the MGMA database. If the CPA/ABV correctly chooses 75th percentile compensation for the valuation model, the excess earnings included in the goodwill valuation will be only $50,000. If he or she chooses, incorrectly, median compensation, the excess earnings will be $100,000, resulting in a valuation overstatement of 200%.

Transaction valuation involving tax-exempt entities. The IRS says physician compensation in a valuation model should agree with any posttransaction employment contract. It also expresses a preference for the discounted cash-flow method, which today is *de rigueur* in exempt entity practice valuations. A hospital or other exempt entity acquiring a practice can't base a physician's posttransaction compensation on median or mean compensation guidelines unless an employment contract so specifies. Under the income approach, a practice's value is based on the future owner's future cash flows. If that owner is a third party such as a hospital and all future cash flow is used to pay physician compensation, the value under the income approach will be zero.

Physician-to-physician transaction valuation. In these transactions the CPA/ABV needs to look closely at what the buyer is buying. Compensation (cash flow) in a physician practice typically is based on employment contracts and compensation formulas, not equity. Valuing equity based on practice-wide excess earnings, for example, when the buyer won't receive a share of those excess earnings based on equity, leads to an irrational result. Buy-in prices for physician practices typically are based on the difference

PRACTICAL TIPS

To properly employ the income approach,

- **Identify how much revenue depends on Medicare, HMOs or health insurers and assess future cash flow. Determine reasonable physician compensation for the valuation model.**
- **Analyze the relative risk of various physician and surgeon specialties to determine the correct discount rate.**
- **Quantify a realistic growth rate in future net cash flow to build a discounted cash flow (DCF) model and to compute the capitalization rate.**

in compensation for the new owner vs. that earned as an employee. A buy-in price often comes out of pretax dollars via a compensation shift from the purchaser to the seller.

Divorce valuation. In determining a marital litigant's excess earnings, analysts often make the mistake of subtracting from the actual earnings a mean or median salary cited in a source such as MGMA. If the jurisdictional standard of value is fair market, and those excess earnings are capitalized to determine the intangible value of the practice, the result is suspect. Physicians' compensation typically is based on productivity—the more you do the more you make. The accepted interpretation of reasonable compensation under the fair market value standard is the salary necessary to hire a nonowner replacement physician of equal experience. In other words, the CPA/ABV must distinguish between the return on labor and the return on capital or equity, for example:

	Total	Ancillary	Nonowner MDs	Owner MDs
Revenues	$1,000	$200	$500	$300
Operating expenses	700	160	400	140
Profit before compensation	300	40	100	160
Compensation	300			
Net Profit	$ 0			

The return on labor to owner physicians is $160, while the return on equity from owning a practice with profitable ancillary equipment ($40) and employed physicians ($100) is $140.

In distinguishing return on labor from return on equity, the CPA/ABV also must consider whether actual compensation includes distribution of profits from ancillary testing equipment such as labs or imaging, profits from nonowner associate physicians, or profits from physician extenders such as nurse practitioners, physician assistants or certified registered nurse anesthetists.

The discount rate: Relative risk of physician specialties. CPA/ABVs must evaluate risk on a case-by-case basis, but there are fundamental factors to consider, particularly in specialty practices. The exhibit at right, posits a risk-premium hierarchy in medical practices. Represented from top to bottom is the relative degree to which the revenue of specialists and surgeons is based on the risks associated with individual skills plus referrals from other physicians. But there are no absolutes.

For example, a key cash-flow risk in a cardiac surgery practice is that a surgeon typically sees a referred patient preoperatively, in the OR and again postoperatively, and receives a single global fee for that basket of services. The patient rarely is seen again. In an internal medicine or pediatric practice, a doctor may see a patient many times during the year, lowering the risk to continued cash flow. Among factors to consider is that a bad surgical result is more likely to reduce a surgeon's future referrals than a bad outcome from treating a sinus infection.

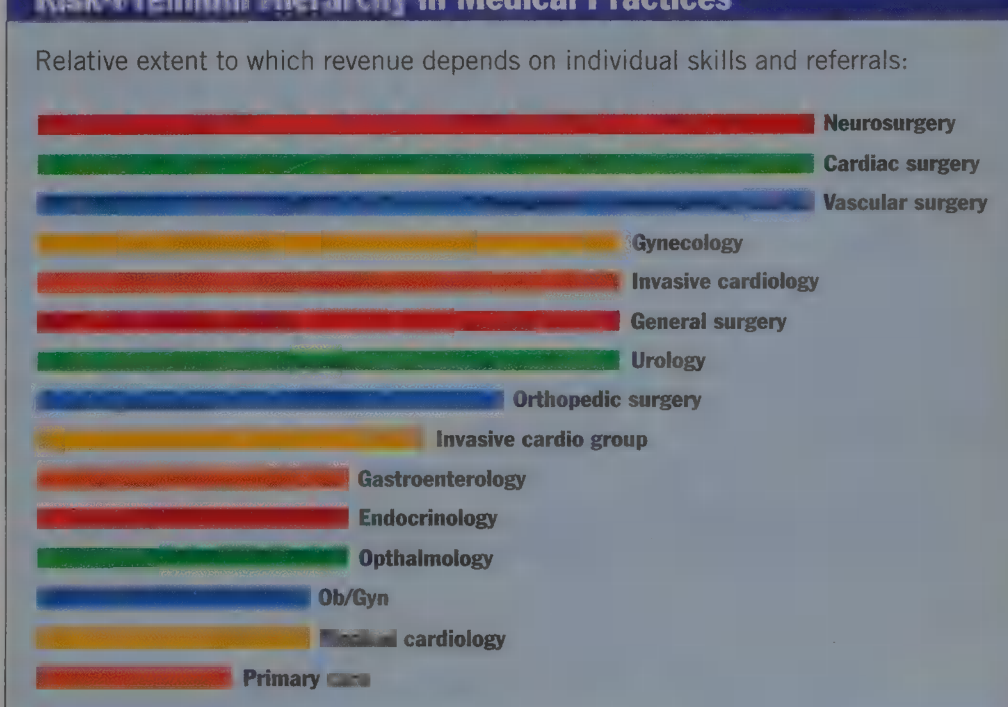
In another example, an orthopedic practice with a significant sports medicine component will have a customer base asset worth more than an orthopedic practice focused solely on hand or back surgery. Pure interventional or invasive cardiology practices, which rely on referrals from independent medical cardiologists, are likely more risky than a group consisting of *both* medical and interventional cardiologists.

Cash-flow growth rate. The growth rate in future cash flow depends on two separate components: the growth or decline in number of units of service provided (unit sales) and the growth or decline in the price paid for each unit of service. Basic cost accounting incorporates these price and volume variances.

Unit prices. The CPA/ABV quantifying a realistic growth rate in future net cash flow has to consider that for doctors in a typical small medical practice increasing unit prices to enhance revenue is a less risky move than expanding services. However, Medicare and Medicaid regulatory guidelines and related penalties impose serious constraints on service unit prices, and health insurers offer little room for change. To determine a reasonable growth rate in net cash flow for purposes of a DCF model, and/or for purposes of a terminal growth rate to determine the capitalization rate, a CPA/ABV needs to assess the practice's capacity for treating additional patients and its ability to expand services.

Units of service. The CPA/ABV considering growth rates must assess the demand for the services, the physical and personnel capacity to meet the growth, the capital investment necessary to handle added volume and other fac-

Risk-Premium Hierarchy in Medical Practices



Be certain the assumptions you use in the valuation model conform to the jurisdictional definitions of "fair market value."

tors. A typical primary care physician can accommodate only 4,500 or so visits per year.

Mix of services. The mix of services can change for some types of medical practices, offsetting unit price restrictions and capacity issues. In radiology, for example, advanced and highly paid technologies such as magnetic resonance imaging (MRI), computed tomography (CT) and now positron emission tomography (PET) scanning have experienced double digit growth, partly at the expense of poorly paid radiography. More affordable MRI units offer cardiologists and orthopedists enhanced incomes. CPA/ABVs should be aware that as a result of spending growth, Medicare announced dramatic cutbacks in per unit revenue for both MRI and CT in August 2005, as well as the inclusion of PET scanners in the Stark laws. This will have a significant impact on future profits and value.

REGULATORY FACTORS

Besides knowing the correct quantitative assumptions to use in a valuation model, the CPA/ABV must be familiar with the Stark laws; the Anti-Kickback statute; the Intermediate Sanctions Provision of the Internal Revenue Code; and OIG Special Advisory Bulletin, *Practices of Business Consultants* (June 2001; **www.oig.hhs.gov/fraud/docs/alertsandbulletins/consultants.pdf**). The substance of the Stark laws can be found in section 1877 of the Social Security Act (42 USC 1395nn). Information on the Stark laws and the Anti-Kickback Statute also is available online through the Federal Register at **http://www.gpoaccess.gov/fr/index.html**. The Stark laws limit physicians' financial relationship (defined as an ownership or investment interest) in entities to which they refer patients. Stark II regulations prohibit referring physicians from owning an interest in businesses to which they refer and also require that contractual relationships between referring physicians and other parties be consummated at fair value.

Detailed discussion of these regulations is beyond the scope of this article, but a CPA/ABV should be aware that buyer-seller factors common in valuing other types of businesses are different in the health care industry. For example, a Dunkin Donuts operation's rent inside a supermarket likely reflects the customer traffic in the supermarket, but under Stark regulations, an MRI operation's rent in a medical office building owned and occupied by orthopedists and neurologists is not allowed to reflect the value of traffic needing MRIs.

DO NO HARM

Medical practice valuation has entered a new era in which market data have limited relevance. No comprehensive transaction database exists for medical practices in the current environment, and CPA/ABVs and their clients must rely on a disciplined use of income-approach methods. In valuations subject to regulatory or court review, you must be certain the assumptions you use in the valuation model conform to the jurisdictional definitions of "fair market value" and that your valuation considers the complex interrelationship of current conditions and known trends in the payment for physician services. ■

RESOURCES

AICPA Resources

To request information about obtaining the AICPA's Accredited in Business Valuation (ABV) credential, send an e-mail to abv@aipca.org, call the ABV Hotline at 212-596-6211 or download the ABV Handbook at **www.aicpa.org/download/abv/abv_handbook.pdf**.

Conference

AICPA/ASA National Business Valuation Conference
November 14–16, 2005
Bellagio Hotel
Las Vegas

Publications

- "Computing the Growth Rate in Physician Practice Revenue" by Mark O. Dietrich, *CPA Expert* (Winter 2005).
- "Defending Against Unwarranted Damage Claims in a Medical Practice Dissolution" by Mark O. Dietrich and John Mayerhofer, *CPA Expert* (Winter 2000).
- *Financial Valuation: Applications and Models*, edited by James R. Hitchner, John Wiley & Sons, 2003 (# WI061387P0200DJA) and *Financial Valuation Workbook* (# WI220833PO200DJA).

For more information, to place an order or to register, go to **www.cpa2biz.com** or call the AICPA at 888-777-7077.

Other Resources

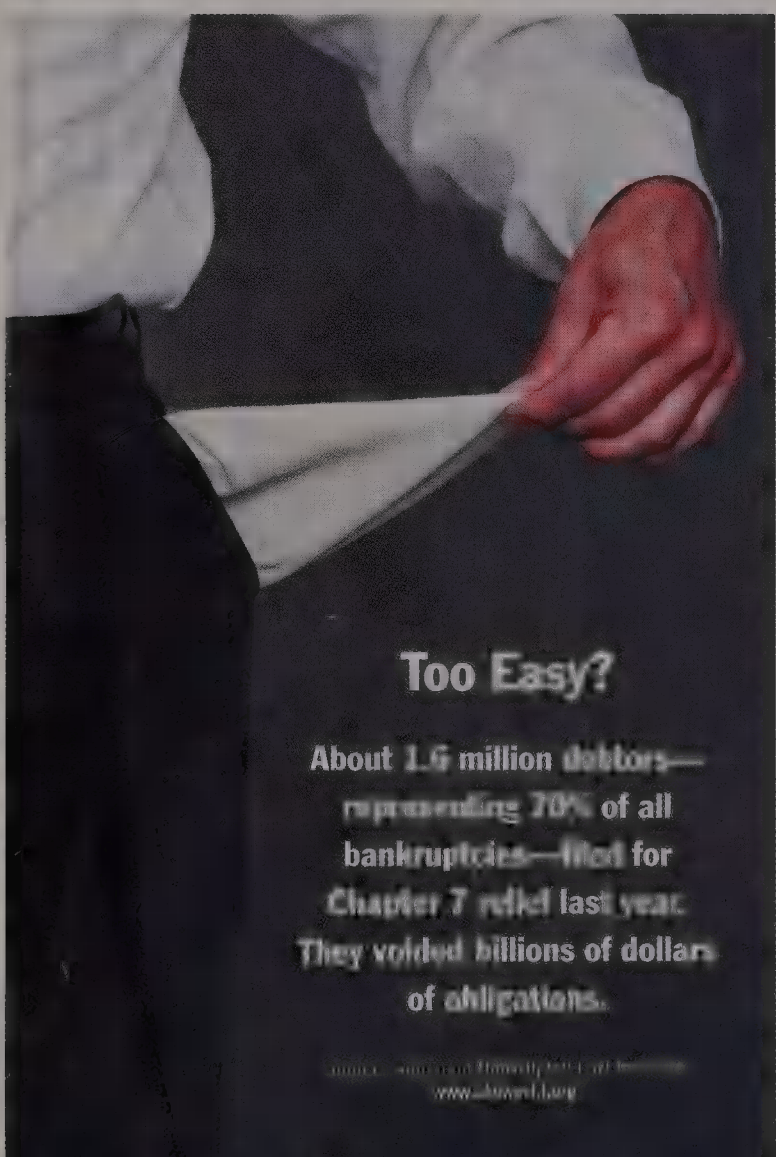
"The Direct Market Data Method: Common Errors in Application and a Closer Look at the Transaction Databases" by Nancy J. Fannon and Heidi P. Walker, *Business Valuation Alert* (September 2003).

At one time a Chapter 7 filing let debtors off the hook—no more.

Bankruptcy Reform Is Here

BY LAWRENCE S. CLARK, RANDALL HANSON AND JAMES K. SMITH

The ease with which debtors have been able to walk away from debt has frustrated creditors for years. But all that changed last April when President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 into law. Most provisions became effective last month. The legislation—in the works for eight years—is the result of intense lobbying, mainly by banks and credit card companies. Now debtors with severe financial problems will find it harder to secure relief, and many consumer-protection groups fear that restricted access to Chapter 7 will unfairly hurt individuals whose impoverishment results from calamities like Katrina and Rita. CPAs need to understand the changes so they can advise clients. This article will bring them up to date.



THE KEY CHAPTERS

To grasp the impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, it helps to understand the characteristics of the three most common forms of bankruptcy: Chapter 7 (liquidations), Chapter 11 (reorganizations) and Chapter 13 (adjustments). Traditionally Chapter 7 discharged most debts completely, allowing debtors to secure a fresh start. Many creditors have viewed it as an invitation to abuse.

Chapters 11 and 13 essentially are unchanged under the new law. Chapter 11 lets a troubled business reorganize and develop a recovery plan; it holds off creditors while the plan is implemented. Chapter 13 lets wage earners develop a recovery plan but doesn't discharge significant debts. The goal of 11 and 13, which are more creditor-friendly than Chapter 7, has been to help troubled debtors develop realistic payment plans, become financially stable and repay their debt.

THE CHAPTER 7 PROCESS

The primary feature of the new legislation is that distressed individuals no longer have free access to Chapter 7's easy discharge of debt. Now, debtors must undergo a "means

Many large entities have gone into Chapter 11 and come out strong vibrant businesses.

test" and credit counseling to assess whether to permit them to choose Chapter 7 relief. As a result, many individual debtors likely will be funneled into Chapter 13, which requires them to repay their debt over time.

To obtain Chapter 7 relief, a debtor files a petition with the bankruptcy court. For eligible debtors (formerly both businesses and individuals, now businesses and some individuals) the process is not much changed. The court appoints a trustee to represent creditors and act as an independent party responsible to the court. The debtor is required to turn over all nonexempt assets to the trustee and to list all creditors so they can be notified of the bankruptcy filing (see "No Privacy in Bankruptcy," page 61). The creditors have to file a claim for the amount they are owed.

Trustees have a number of powers to protect creditors. They can request the return of preferential payments to favored vendors and can set aside fraudulent transfers intended to hide assets. Trustees also can seize inheritances to which the debtor becomes entitled within 180 days of a Chapter 7 filing. After accumulating all assets, trustees distribute any monies obtained according to priority-distribution rules. Paid first are secured parties, administrative costs, unpaid wages and pension obligations, alimony and child support and taxes; finally, general unsecured parties are paid pro rata.

Debtors are allowed to keep exempt assets to help them start over. The exemptions vary from state to state, but generally include a homestead exemption and an exemption for a car, tools and specified personal property.

CHAPTER 11 RELIEF

Businesses undergoing hard times can file under Chapter 7 or 11. While Chapter 7 provides for a liquidation Chapter 11 is designed to protect businesses whose distress can be corrected. It assumes a business can be rehabilitated given a viable recovery plan and a modified payment schedule.

Once a business files for Chapter 11 with the bankruptcy court creditors must temporarily refrain from attempting to collect debts. For the first 120 days after filing, the business has the right to work out a viable recovery plan proposal. If it does not succeed, the creditors step in to submit one. The bankruptcy judge has the authority to approve a plan. Typically the court won't appoint a trustee to manage the business, and the same people continue under the new plan except that the bankruptcy judge supervises and approves certain expenditures and business decisions. The judge has the power to convert to a Chapter 7 bankruptcy if there is no hope of saving the business. Many large entities have gone into Chapter 11 and come out strong vibrant businesses.

CHAPTER 13 RELIEF

Chapter 13 allows financially distressed individual debtors to create a court-supervised five-year repayment plan (formerly

EXECUTIVE SUMMARY

- **CPAs NEED TO UNDERSTAND THE IMPACT** of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 so they can advise clients how their relationships with or as debtors is altered. The two most important changes are the terms of access to Chapter 7 and changes to the homestead exemption provisions.

- **IN CHAPTER 7 DEBTORS NOW HAVE TO** undergo financial counseling and a budget analysis from a court-approved, nonprofit agency. The court appoints a trustee to accumulate all assets and distribute monies. Paid first are secured parties, administrative costs, unpaid wages and pension obligations, alimony, child support and taxes; then general unsecured parties are paid pro rata. Exempt assets vary by state.

- **THE THREE MAIN BANKRUPTCY LAW CHAPTERS** are 7, 11 and 13. Under the new law individual debtors have to undergo a means test to qualify for Chapter 7 relief but businesses do not. Chapter 11 lets a business develop a recovery plan and holds off creditors while it is implemented. Chapter 13 lets wage earners develop a recovery plan without discharging much debt. Both 11 and 13 help debtors develop payment plans, become financially stable and repay their debt.

- **CHAPTER 13 ALLOWS FINANCIALLY DISTRESSED** individuals to create a court-supervised five-year repayment plan. Before debtors can complete either a Chapter 7 or 13 bankruptcy action and receive a discharge, they will be required to complete a financial management course.

- **DEBTORS CAN'T EVADE RESPONSIBILITY** by moving to a state with a better homestead exemption; they must live in the state for at least two years before filing for bankruptcy.

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a three- to five-year program). During the specified period the debtor pays a portion of his or her disposable income to the trustee, who then pays the creditors. Payment schedules can be modified under Chapter 13, and some obligations can be fully discharged. Debtors get to keep some property rather than turning it all over to a trustee. Creditors have always preferred Chapter 13 since the debtor strives to repay a significant portion of his or her obligations. Chapter 13 is better for creditors than Chapter 7, but almost two out of three Chapter 13 filers ultimately fail to fulfill their plan according to the American Bankruptcy Institute.

NEW LEGISLATION: CONSUMER BANKRUPTCIES

The two most important changes to the U.S. Bankruptcy Code are the terms of access to Chapter 7 and changes to the homestead exemption provisions.

Access to Chapter 7. Under the new legislation businesses still can seek Chapter 7 relief without undergoing a means test; individual debtors must undergo a means test to qualify. People who don't qualify go into Chapter 13 plans, and most will have a five-year period to repay debts. Only a limited group of debtors can obtain a discharge and a fresh start as easily as before.

A person in financial trouble now has to undergo financial counseling and a budget analysis from a court-approved nonprofit agency within six months of filing for bankruptcy protection. In some cases counseling may enable debtors to develop their own informal rehabilitation plan. If debtors still wish to proceed into bankruptcy court, the next step is determining whether their income exceeds the state median. Debtors with income below the median for their home state can proceed to Chapter 7 (assuming creditors don't challenge and there are no existing issues or actions regarding potential fraud).

Previously debtors and bankruptcy judges could choose the chapter of the code under which to file. Now if a debtor has an above-median income, he or she *must* proceed to a means test. The law presumes "abuse" is likely if a debtor's current monthly income (as determined by the previous six-month average) less secured payments divided by 60, less priority debts divided by 60, less the allowed expenses per region permitted by the IRS, less certain other allowed expenses is greater than $100 a month.

The means test, which takes place under the supervision of the debtor's attorney, deducts standardized living and housing payments from the debtor's monthly income; then transportation costs based on IRS tables; then monthly health insurance costs; then secured payments on automobiles over 60 months. If the gross monthly income minus those deductions leaves $100 or more, the debtor will be denied Chapter 7 relief. That is, if debtors can pay $6,000 over five years toward creditors' claims they must set up a payment schedule under Chapter 13.

Debtors can rebut the presumption of abuse only by demonstrating special circumstances that justify expenditure or income adjustments. The legislation doesn't define those special circumstances, so it isn't clear how much latitude courts will give debtors to challenge a monthly income calculation that is skewed or in which ongoing catastrophic health expenses have in effect become "usual."

In calculating a debtor's secured debt obligations, bankruptcy courts formerly divided the debt so that only the fair value (generally the depreciated value) was considered secured; the remainder was considered unsecured. Under the new law, all loans secured by property within one year before bankruptcy and for vehicles in the 910 days before bankruptcy must be paid in their en-

RESOURCES

AICPA Resources

Publications

- AICPA *Professional Standards*, paperback, # 005105JA; loose-leaf, # PS_XX12JA; CD-ROM, # DPSXX12JA; online, # WPS-XXJA.
- *Bankruptcy and Insolvency Accounting: 2 Volume Set* by Grant W. Newton and Gilbert D. Bloom, John Wiley & Sons, 2000 (# WI331449P0000DJA).
- *Bankruptcy and Insolvency Taxation* (3rd ed.) by Grant W. Newton and Robert Liquerman, John Wiley & Sons, 2005 (# WI228087JA).
- Consulting Services Practice Aid 02-1, *Business Valuation in Bankruptcy* (# 055296JA).
- Consulting Services Special Report 03-1, *Litigation Services and Applicable Professional Standards*, 2002 (# 055297JA).

For more information or to order, call the Institute at 888-777-7077 or go to **www.cpa2biz.com**.

Other Resources

Publications

- *Bankruptcy Code, Rules and Official Forms* (2005 edition), West Publishing, 2005.
- *Understanding Bankruptcy Reform 2005: What Consumer Bankruptcy Attorneys Need to Know About the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, LRP Publications, 2005.

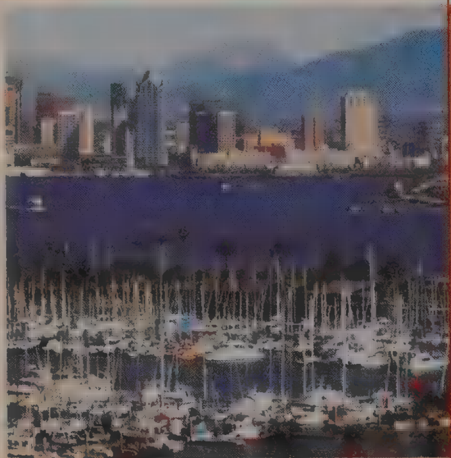
Web sites

- **www.abiworld.org**. The American Bankruptcy Institute home page links to news and forms.
- **www.bankruptcyaction.com**. This site lists bankruptcy lawyers by state and city and offers general information on chapters 7 and 13.

General bankruptcy information

- **www.findlaw.com/01topics/03bankruptcy/index.html**.

AICPA conference



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A controversial new requirement of the act is that attorneys must verify debtor information is correct and "grounded in fact."

tirety. This may have the unintended consequence of leaving the debtor insufficient income to proceed under Chapter 13.

Before debtors can complete either a Chapter 7 or 13 bankruptcy action and receive a discharge, they have to complete a financial management course.

Homestead exemption changes. Exemptions are very important; under Chapter 7 debtors can keep exempt property but must turn over all nonexempt property to the trustee. Although bankruptcy law is federal, each state is allowed to specify exemptions. The most important exemption is the homestead because typically it is the debtor's biggest asset. Debtors under Chapter 7 can keep their home, subject to the size of the state homestead exemption, which can vary dramatically. For example, the homestead exemption is $5,000 in Alabama, but it's unlimited in Florida and Texas. A $5 million Florida home is fully protected from creditor claims, while an Alabama home is protected only up to $5,000. Debtors must keep mortgages on the homestead current or the lender will foreclose.

Under the new law debtors can't evade obligations by moving to a state with a better homestead exemption. A person is eligible for a state homestead exemption only if he or she has lived in that state for at least two years before claiming bankruptcy; if not, the former state's exemption likely will apply. If the debtor has engaged in specified criminal acts, the exemption will be capped at $125,000 even if the state homestead exemption is higher.

Longer Chapter 13 plans. Previously Chapter 13 debt-repayment plans ranged from a three-year minimum to five years; now they are a mandatory five years. Debtors prepare and submit their payment schedules to the judge, who reviews and approves them. The new system takes longer and is more cumbersome to administer. It may require significant new resources such as appointment of more bankruptcy judges to handle the increased caseload and additional supervision.

New documentation requirements. Debtors need to provide a certificate of credit counseling, evidence of recent wages, a statement of monthly net income and expenses, a tax return for the most recent year and a photo ID. A controversial new requirement of the act is that attorneys must verify debtor information is correct and "grounded in fact." Because there are liability implications in this requirement,

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some practitioners think many attorneys will cease to represent individual debtors and that those who do will raise fees substantially. Attorneys also are required to generate additional notices to clients about bankruptcy procedures and recordkeeping responsibilities.

Longer Chapter 7 filing interval. Under the old law a person was permitted to file for Chapter 7 relief every six full years. The interval under the new act is eight.

More nondischargeable debts. The debts that could not be discharged formerly were child support/alimony, some tax obligations, debts incurred by fraud or malicious activities, most student loans, judgments incurred due to driving under the influence of alcohol and government fines. New provisions expand the list. Included are student loans from private as well as government bodies; last-minute debts incurred right before filing for bankruptcy; credit purchases of $500 or more for luxury goods or services made within 90 days of filing; and loans of more than $750 taken within 70 days before filing.

Evictions of residential tenants in bankruptcy. The new act affects clients who are landlords. Under the old law, a bankruptcy petition stopped eviction proceedings. Now a landlord may be able to evict tenants who are not in compliance with the rental agreement even if the tenant files for bankruptcy. Eviction proceedings can continue if the landlord obtained a judgment of eviction prior to the debtor's bankruptcy filing. A landlord that doesn't have a prior eviction judgment may evict if the property is endangered or if drug activities occurred on the premises within 30 days before the debtor filed for bankruptcy.

NEW LEGISLATION: BUSINESS BANKRUPTCIES

The new law also creates a number of changes for businesses seeking bankruptcy protection.

Nonresidential real property leases. Old rules gave businesses 60 days after commencing a bankruptcy to assume or reject nonresidential property leases. The new legislation changes the time limit for the debtor's decision: Nonresidential property leases must be assumed or rejected within 120 days after commencement of the case. An extension of 90 days is permitted, but further extensions require the written consent of the landlord. The net result is that businesses have only 210 days to decide whether to retain leased nonresidential real property. Retail businesses will be severely affected by this change.

Exclusivity period. The new rules place a limit on the time period during which a debtor has exclusive rights to propose a Chapter 11 bankruptcy plan. Old rules had no limitations on the number of extensions a court could grant a debtor. Under the new rules the exclusivity period may not extend beyond 18 months from the date of the bankruptcy petition. After that any interested parties may propose a bankruptcy plan, which could give creditor committees

more power to dictate terms as the 18-month time limit approaches.

Executive compensation. The new bankruptcy rules attempt to curtail a business debtor's ability to pay key employees retention bonuses, severance payments and other payments that could be construed as unethical. Retention payments to insiders (officers and directors) of the debtor are subject to a number of constraints, including the requirement that they're needed to retain people who have received a bona fide job offer. Businesses need to check the rules before committing to any payment promise to executives and other key insiders.

Utilities. The new rules increase the likelihood that utility companies will be paid for services provided after a business files for bankruptcy. The old rules prevented a utility from discontinuing service to a business in bankruptcy protection. The business had to provide only "adequate assurance" that it would pay utility bills, a phrase courts liberally interpreted in favor of the debtor. The new rules limit "adequate assurance" to cash deposits and letters of credit or a form of assurance upon which both the utility and debtor agree. Businesses will have to budget for their postpetition utility bills.

PRACTICAL TIPS

- **Make sure you and your clients understand the changes in bankruptcy law under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.**
- **Inform client landlords how eviction procedures differ under the new law.**
- **Tell business clients not to make payment promises to executives and other key insiders without checking the new rules.**

REMEDIAL ACTION?

The new bankruptcy reform legislation changes the psychology of debt in addition to the law. About 1.6 million people filed for Chapter 7 relief last year, and it will be interesting to see whether legal reforms bring that number down when debtors no longer can easily access Chapter 7 and its discharge of debts. Consumer protection groups say the reform legislation is slanted in favor of the credit industry and doesn't protect consumers. The credit industry shares blame, they say, for unsolicited marketing of preapproved credit that may lure people into living beyond their means. Many are concerned that vulnerable groups such as the poor, the elderly and the sick no longer will be able to obtain bankruptcy protection. Additional changes are likely if the reforms prove unjustly burdensome and the cure turns out to be worse than the condition it was meant to correct. ■

Data in the public record are there for anyone to see.

No Privacy in Bankruptcy

BY THERESA HOLT AND PETER POZNANSKI

PHOTOGRAPH BY DIMITRI VERVITSIOTIS/GETTY IMAGES

CPAs who help clients make the details of their financial lives known to the court during a bankruptcy may understandably get headaches. The Gramm-Leach-Bliley Act and related Federal Trade Commission regulations generally prohibit practitioners from disclosing clients' personal financial information. But bankruptcy statutes take precedence over those restrictions—and require that very same information to go into the public record. Can the conflict of individual right to privacy vs. statutory right to public access be resolved? Even with passage of the Bankruptcy Reform Act questions remain. CPAs who assist in a bankruptcy can present the issues and guide clients through the process professionally and compassionately.

WHAT BANKRUPTCY DOES

Bankruptcy is a judicial process to provide an individual or a business that no longer can pay its debts with relief from financial obligations. It distributes a debtor's property equitably among creditors and enables the debtor to start afresh. The most common bankruptcies are Chapter 7 liquidations, Chapter 11 reorganizations and Chapter 13 adjustments (see "Bankruptcy Reform Is Here," page 51).

In the bankruptcy process, debtors are required to submit a tremendous amount of information to the court. CPAs participate by providing a number of services, which can range from preparing financial documents on behalf of the debtor to helping the court-appointed trustee gather a debtor's financial records (see "The Business of Bankruptcy," *JofA*, Feb.02, page 35). The detailed information lists creditors, assets, liabilities and income, and any additional information explaining the debtor's financial situation. All of this is a necessary precursor to distributing assets equitably among the creditors (see "In the Public Record," page 62).

Generally the public has the right to inspect documents filed with the bankruptcy court. Both statutory and constitutional laws protect this access to court records, and section 107(a) of the bankruptcy code affirms the right of public access. In most cases the news media may obtain court records under the First Amendment as well. Public access aids the administration of bankruptcy cases, promotes public trust and accountability in the system and encourages legal compliance.

If making the data available to the public serves as de facto oversight by

Room to Improve

From October 1, 2003, to September 30, 2004, bankruptcies fell 2.6% to 1.6 million. Bankruptcies still remain at historic highs, well above the 1.5 million record set in 2002.

Source: Administrative Office of the U.S. Courts, Dec. 3, 2004, **www.uscourts.gov**.

shining a spotlight on the process and inviting scrutiny, it also increases the likelihood of the debtor becoming a target of questionable schemes and scams. In limited situations the judge may decide to "seal" documents in the interest of privacy—for example, when information is scandalous and defamatory. The new Bankruptcy Reform Act expands judicial authority to restrict disclosure for additional reasons, including prevention of identity theft.

In the Public Record

This is a partial list of the financial information that goes into a debtor's public record.

- Alimony, maintenance, support and property settlements
- Animals
- Automobiles, trucks and other vehicles
- Boats, motors and accessories
- Books, pictures and art objects
- Cash on hand
- Charitable contributions
- Checking, savings and other financial account numbers
- Current wages, salary and commissions
- Description, location and market value of real property
- Firearms
- Food and clothing expenses
- Household goods and furnishings
- Information related to dependents
- Interests in insurance policies
- Inventory
- Jewelry
- Laundry and dry cleaning expenses
- Marital status of debtor
- Medical and dental expenses
- Monthly rent or home mortgage payments
- Names and addresses of creditors
- Name and address of debtor
- Name and age of spouse
- Recreation, clubs and entertainment expenses
- Security deposits
- Social Security numbers (only the last four digits)
- Sports, photographic and other hobby equipment
- Stocks and bonds
- Tax identification number
- Utilities expenses
- Wearing apparel

THE PROBLEM WITH PUBLIC ACCESS

Opponents of public access say debtors in bankruptcy are vulnerable to illegal, discriminatory and objectionable practices when personal data such as medical expenses and bank accounts are part of the court record. Technology exacerbates the exposure, since anyone anywhere can access electronic court records on the Internet. Those who prey on system weaknesses—such as identity thieves or bogus creditors—use the information, too. Debtors even may experience threats of physical harm, harassment, lender redlining or discriminatory profiling.

Disclosure of highly personal and sensitive data may possibly facilitate identity theft. A Federal Trade Commission survey found that nearly 10 million people were victims of identity theft during 2002, costing businesses and consumers billions of dollars.

HOW CPAs CAN HELP

CPAs can take a number of actions to help individual clients cope with bankruptcy. They can

- ***Inform clients about the bankruptcy process.*** Clients need to know the extent to which their personal and financial information will become public. Some clients may be tempted to withhold certain financial information from the court. CPAs must let them know they have to meet the disclosure requirements of the bankruptcy statutes.
- ***Tell clients to expect—and be wary of—solicitations.*** Once their personal information goes into the public record, clients likely will be deluged with offers for credit cards, goods, services and high-interest deals to reestablish credit.
- ***Provide financial planning.*** Clients may need long-

EXECUTIVE SUMMARY

- **LAWS AND REGULATIONS PROHIBIT CPAs** from disclosing clients' personal financial information, but bankruptcy statutes require that very same information to go into the public record. CPAs can't change the law, but they can help clients get through the bankruptcy process.

- **PUBLIC ACCESS AIDS THE ADMINISTRATION** of bankruptcy cases, promotes public trust and accountability in the system and encourages legal compliance. Unfortunately, it also increases the likelihood of the debtor becoming a target of scams.

- **CPAs CAN HELP CLIENTS COPE** with bankruptcy in a number of ways. They can inform them about the extent to which their personal and financial information will become public—and let them know that they must meet all the disclosure requirements of the bankruptcy statutes.

- **BANKRUPTCY ISN'T THE ONLY OPTION.** Alternatives such as a nonstatutory contract to which both debtor and creditors consent give creditors a prorated share of their claims and discharge the debtor's balance. Other alternatives are an agreement to pay down debt over a longer time and credit counseling to negotiate debt-reduction terms.

- **MANY CLIENTS BOUNCE BACK.** Being available, expressing a willingness to maintain a working relationship, answering questions, preparing financial documents and easing the aftershock are important functions for CPAs to perform. CPAs who help clients handle the bankruptcy process are trusted advisers in more than name.

THERESA HOLT, JD, is an attorney and associate professor and PETER POZNANSKI, CPA, PhD, is an associate professor at the College of Business Administration, Cleveland State University, Ohio. Their e-mail addresses are t.holt@csuohio.edu and p.poznanski@csuohio.edu, respectively.

range advice to avoid financial difficulty and prevent further bankruptcies.

■ ***Be available for clients.*** Bankruptcy doesn't negate a client's need for the services of a trusted adviser to reestablish credit, procure reasonable interest rates and prepare tax forms.

■ ***Be supportive when clients vent.*** Some clients may manifest shame, embarrassment and depression. If clients choose to talk about their distress, remind them that while bankruptcy may bring lifestyle changes, it provides some relief from financial pressures and its burdens are not permanent.

■ ***Suggest alternatives to bankruptcy.*** Filing for bankruptcy is not the only way to handle financial problems. There are alternatives such as a nonstatutory contract (a composition) to which both debtor and creditors consent; it gives creditors a prorated share of their claims and discharges an agreed-on balance. Another alternative is an extension that allows them to pay down debt over a longer period of time.

■ ***Suggest credit counseling.*** Credit counseling, from a for-profit or not-for-profit entity, can help debtors negotiate debt-reduction terms. CPAs can help them find a reputable source (see "Resources," below).

■ ***Make attorney referrals.*** Assist in finding the best bankruptcy lawyers for the client's situation. Besides offering counsel, attorneys can help the debtor negotiate debt-reduction terms with creditors. And networking with attorneys also can yield referrals for the CPA.

■ ***Stay in touch—and increase goodwill.*** Don't write off clients who go bankrupt. Many bounce back from insolvency and experience financial success. They, their family and their friends may appreciate your loyalty and give you business—and a great reputation.

■ ***Inform clients of postbankruptcy legal protections.*** Clients should be aware that laws protect them. For example, the Federal Consumer Credit Protection Act prohibits an employer from firing or discriminating against a client involved in a Chapter 13 bankruptcy whose wages are garnished.

KEEPING A BALANCE

Although the bankruptcy process turns personal data into public information, CPAs can help clients handle the stresses in a number of ways. Being available, expressing a willingness to maintain a working relationship, answering questions, preparing financial documents and easing the aftershock are important functions for the CPA to perform. The position of trusted adviser can be earned by being there in hard times, too. ■

PRACTICAL TIPS

▶ **Don't write off clients. Staying in touch increases goodwill.**

▶ **Be available for clients. Bankruptcy does not negate the need for CPA services.**

▶ **Provide clients with financial planning. Help them steer clear of future financial difficulty.**

RESOURCES

AICPA Resources

■ AICPA *Professional Standards.*

■ AICPA/CICA Trust Services Privacy Principle and Criteria, **www.cpawebtrust.org**.

■ AICPA Privacy Initiatives and Resource Center, **www.aicpa.org/privacy**.

■ *Dealing With the IRS* by Allen Brown (# 732261JA).

■ Consulting Services Special Report 03-1, *Litigation Services and Applicable Professional Standards—2002* (# 055297JA).

For more information or to order, call the Institute at 888-777-7077 or go to **www.cpa2biz.com**.

Other Resources

Collier on Bankruptcy (Matthew Bender, 15th ed., rev.), **www.lexisnexis.com**, 800-223-1940.

Financial Privacy Resources

■ Privacy Rights Clearinghouse
3100 5th Avenue, Suite B
San Diego, CA 92103
619-298-3396
www.privacyrights.org
E-mail: prc@privacyrights.org

■ The Pacer Service Center
(The federal judiciary's centralized registration, billing and technical support center for electronic access to U.S. District, Bankruptcy and Appellate Court records)
PO Box 780549
San Antonio, TX 78278
800-676-6856; 210-301-6440
http://pacer.psc.uscourts.gov

Consumer Credit Resource

Consumer Credit Counseling Services
(A division of Money Management International)
9009 West Loop South, Suite 700
Houston, TX 77096
800-873-2227; 713-923-2227
www.moneymanagement.org

Web sites

■ **www.uscourts.gov/bkforms/bankruptcy_forms.html**
This site provides general information about filing a bankruptcy case, forms and a *Bankruptcy Basics* brochure.

■ **www.totalbankruptcy.com**
This site offers a Debt Test to measure your risk, a free case evaluation and a time line of actions to take. Visitors can also read related articles and get an overview of Chapters 7 and 13.

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AICPA 3640

Three international leaders representing accountants in business and industry talk about the profession.

The Future Has Never Looked Brighter

BY PETER D. FLEMING

Where are we going, where have we been and how can we best reach our destination together? These are some of the subjects on the minds of the chief executives of the world's leading accounting organizations representing more than 335,000 members around the globe who work in business and industry. Steve F. Vieweg, president and CEO of the Certified Management Accountants of Canada (CMA Canada) with 35,000 members in Canada and abroad, Charles B. Tilley, CEO of the Chartered Institute of Management Accountants in London, which has 150,000 members and students worldwide, and AICPA president and CEO Barry C. Melancon, representing the Institute's 150,000 members in business and industry, sat down recently with *Journal of Accountancy* senior editor Peter D. Fleming to explore the state of management accounting today.

While many U.S. CPAs might think of management accounting in a very narrow sense based on the cost accounting course they took in college, other countries, particularly Canada and the United Kingdom, use the term to describe the full range of accounting, finance, strategic management, tax and advisory services performed by accountants who work in business and industry.

JofA: *Can we start by coming up with a broad definition of management accounting and the kinds of activities its practitioners engage in today?*

Steve Vieweg: Management accounting began by looking at and controlling costs. Now we have a much wider field that includes things such as risk analysis and the supply chain as well as management concepts that help with decision making, such as the balanced scorecard. It's really grown exponentially.

Charles Tilley: Management accounting is the language of business. If somebody asks about your inventory and you determine you have 10 computers worth $1,000 each, the inventory figure is $10,000. That's absolutely correct, but it's a completely useless piece of information. If you sell 10 computers a day and there isn't a lorry coming into the warehouse unloading more computers, you're going to run out of stock very quickly. What you really need to know is how many computers to order to meet demand. Management accounting is about transforming information into something useful. It tells a company exactly where it is today and then helps the board of directors plan where it's going. Without this kind of help, management is flying blind.

Barry Melancon: I'd say management accounting also is about developing a system that measures performance and provides information that allows a company to formulate strategy, make decisions and maintain control. It's the nerve center of an organization.

JofA: *What benefits do businesses get from employing management accountants? What critical skills do they bring to the table?*

Vieweg: At CMA Canada we're introducing a brand new competency map focusing on two areas. One is performance responsibilities, which includes being able to work with people in a team environment and having good judgment skills. The other area is conformance responsibilities. That's a value-added assurance concept, such as making

The United Kingdom's Charles Tilley, left, and Steve Vieweg of Canada represent nearly 200,000 management accountants in the United Kingdom, Canada and around the world. Both agree management accountants are critical business partners who help create value and drive change.

sure you understand inventory practices, GAAP and the like. Management accountants are increasingly being seen as the people who drive change within an organization.

Tilley: All businesses are out to create value. Management accountants are critical partners in that process because they ensure the correct financial decisions are made and provide the structure for financial decisions about where the company is and where it's going.

Melancon: In addition to reliable decision making, accountants who work in business and industry also are positioned to bring a combination of integrity, confidence and ethical conduct to the table.

JofA: *Looking at the history of management accounting, how have the contributions of management accountants changed?*

Vieweg: In the last part of the 20th century, management styles changed significantly. Management used to be a command and control structure where almost every decision was made at the top. What we've seen evolve is a more decentralized reporting and decision structure. Organizations today face myriad options and challenges. They need management accountants to step in and work at any level as part of a team.

Tilley: Over the last 50 years there's actually been nothing much new in management accounting. I spoke earlier about creating value; that situation has applied ever since business began. When I talk to some of our senior retired members, what they were doing before World War II and what we're doing today are not that different. What has changed are the issues, such as the environment or the speed of technology. The ability to make decisions quickly and be an effective partner also has changed dramatically. And the whole issue of ethics couldn't be more important. You have to be what I call an "honest Joe." Being a very good communicator is critical as well.

Melancon: The evolution really is about the professionalization of the management accounting function. Looking at the changes over the past 50 years, some of the functions have remained the same, but now they're perceived as having moved from a functional responsibility to a professional one. Today more than 50% of U.S. CPAs work in business and industry. The need for a high level of competency and professionalism has driven companies to meet their needs at a professional level.

JofA: *Turning from the past to the future, what do you see ahead for management accounting and those in business and industry who practice it?*

Vieweg: The future has never looked brighter. Every management accountant must have his or her roots in financial accounting, specifically GAAP. Beyond that, the required skill set evolves daily. In general, management accountants need judgment and analytical skills and an ability to work well with colleagues.

Tilley: I agree the future has never been brighter. For the profession to really flourish it is absolutely key to keep on top of technology, to identify critical issues and to be part of the management team. You've got to be a team player and that includes being a good communicator. *(continued on page 68)*

PHOTOGRAPHS BY DENNIS MILBAUER

Melancon: In the future, management accountants must be on the leading edge of issues. One is globalization for both small and large companies. U.S. CPAs will be key players in corporations that engage in cross-border activities. Conversely, management accountants in England and Canada will be key players for businesses that want to focus on the United States. Obviously, technology changes by the moment, and management accountants have to be on top of that and understand its potential to increase value.

JofA: *What advice can you give someone who wants to pursue a career in management accounting?*

Vieweg: This goes back to my days at the recruitment booth trying to attract people to the CMA program. Management accounting is not for everyone. What we tell students is to look at their own needs and where they see themselves down the road. Just as important is your potential employer. Among the key skills students should have a desire to contribute to the growth of an enterprise and to be involved in teamwork. The bottom line is one word—communication. You have to be able to communicate with colleagues, subordinates, management and shareholders. If that doesn't interest you, management accounting is not the career you should pursue.

Tilley: Assuming you've decided management accounting is something you really want to do, I suspect all of us would say that our individual designations—CPA, CMA or CIMA—are a qualification for success. You then have to choose the right organization to train with—one that will offer you a broad foundation of experience. Your employer is the link between the credential and the academic and practical experience that ensures you'll become a good management accountant.

Melancon: Today is a great time to make the move to what is known internationally as management accounting. The business changes around the world, led by Sarbanes-Oxley in the United States and the expectations of transparency, are greater than ever before. Because management accounting has become a professionalized function, the credential is a key starting point. Each of our organizations represents a credential with a different focus but with a common goal. In the United States the CPA designation clearly is the starting point for a company that wants to hire someone who meets the ideals we're talking about. It's important that you be someone who is motivated by, responsive to and confident in the broad responsibilities of being a senior-level thought leader.

The AICPA's Barry Melancon says in the United States the CPA credential is viewed as the right designation for top-level management personnel and accounting and business executives.

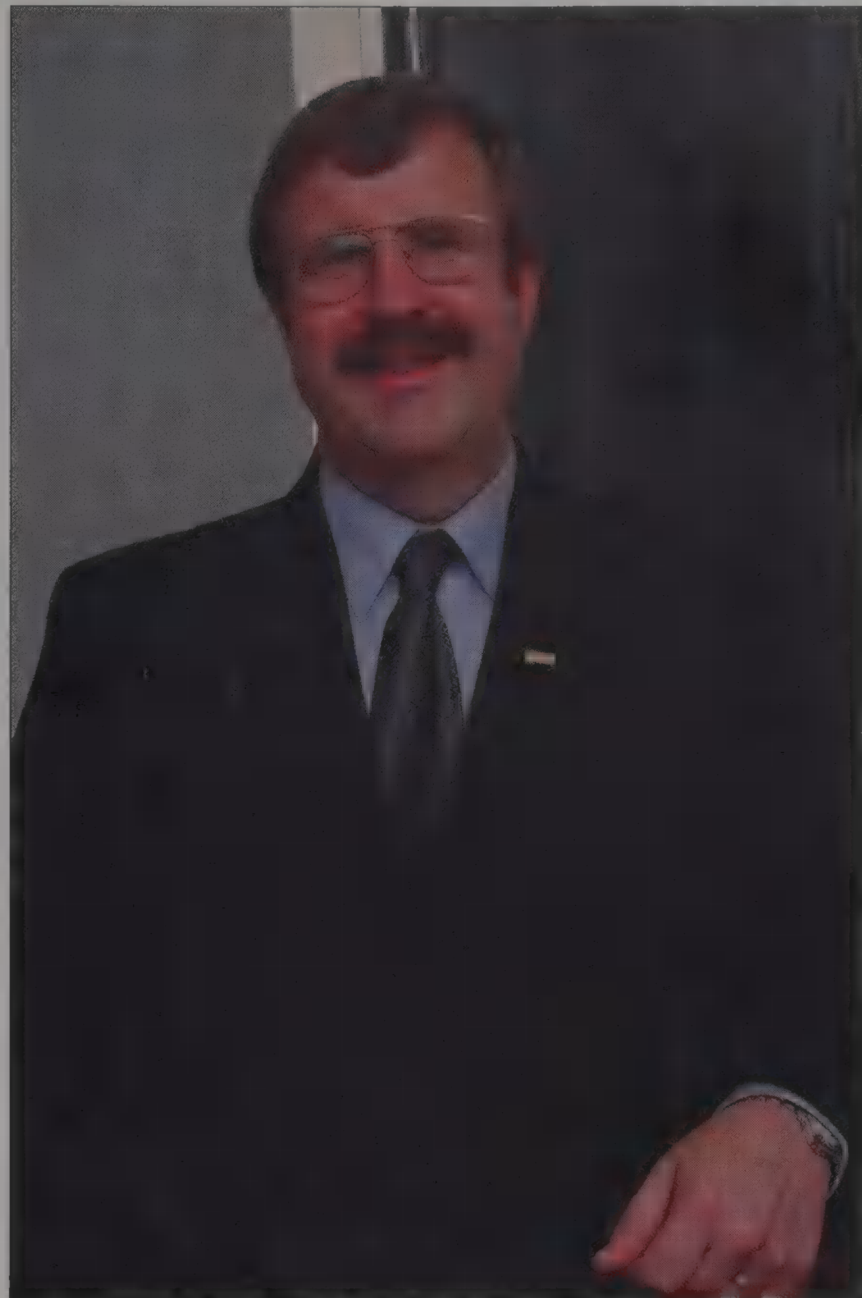
JofA: *Tell us about the organizations you represent and your members and what you do to serve their needs.*

Vieweg: We have a membership of 35,000 CMAs based primarily in Canada. We also have 3,000 candidates who are studying to become CMAs. Our vision is to be the credential of choice for business. When a business is looking for a management accountant or needs research information or products dealing with management accounting, our goal is for them to contact us.

Tilley: CIMA has 150,000 members and students around the world. Our core market is the United Kingdom and parts of Asia and Africa; we have around 2,000 members and students in the United States. We're looking to expand by association with other organizations in the United States and the rest of Europe. Our purpose is very simple: to improve the employability of our members in management accounting. We aim to provide what employers are looking for. We offer a substantial amount of CPE support and focused ethics guidelines for accountants in business. Part of our royal charter from the Privy Council, along with qualifying and training accountants, is to further the science of management accounting and be on the cutting edge of thought leadership on technical and accounting issues. We

also focus on ethics. We all operate under the IFAC code of ethics that has been revised across the profession, but specifically for accountants in business.

Melancon: Of the AICPA's 350,000 members, some 150,000 are involved in some aspect of financial management. It's an extremely large constituency for us and a very important one for business reporting, financial reporting and management accounting in the United States. It's part of what makes the American economy successful. We offer a combination of training and CPE, leading-edge information exchange and tools individuals can use to make themselves more valuable in their organizations and, more important, to make the organizations more successful. We also focus on services members can leverage to create benefits for their organizations. And we advocate for business with groups such as the SEC, the PCAOB and the IRS.



Steve Vieweg of CMA Canada says today's organizations need management accountants to step in and work at any level to help companies deal with the myriad challenges they face.

JofA: *We've heard the word communication a lot today. How do you help your members communicate better?*

Vieweg: We offer our members communication courses. And at our conferences, which about 20% to 25% of our members attend, we make sure communication is an integral part of the agenda.

Tilley: Across the world today's young people are much better communicators than those 20 or 30 years ago. People coming out of college and university have much better communication skills. We do a lot of the same things as CMA Canada in terms of CPE courses, but there's room to do a lot more.

Melancon: We help people communicate by providing them with flexible tools. We produced a free CD-ROM members in business and industry can deliver to their boards to help focus top management on fraud prevention and detection. On the audit committee side we created an evergreen document CPAs can use in a turnkey environment to help audit committees be more effective. To help streamline the communication process, we encouraged CPAs to download the material and customize it to their particular needs.

JofA: *Both CIMA and CMA Canada offer professional certification for management accountants. How do these programs help those who hold the designations?*

Vieweg: We just introduced a new competency map and it stands on three pillars—strategy, accounting and management. Our competencies reflect the relationship between these three pillars and we believe there needs to be a balance among them. This is what differentiates us from our competitors. We will make sure all our products and services, accreditation and post-designation learning align with the new competency map.

Tilley: There are tangible benefits from the CIMA designation. A new U.K. member's salary is somewhere around 200% of average U.K. earnings. That indicates the credential is worth shooting for. If you look through job advertisements in any country where we have a significant presence, you'll see either a request for a qualified accountant—which includes CIMA—or a specific reference to our credential. Also look at the accounting "rock stars." At Tesco, the United Kingdom's biggest retailer, finance director Andrew Higginson is one of our members, as is Douglas Flint, finance director of HSBC, which calls itself "the world's local bank." These people are role models for students leaving university and considering a career in management accounting.

Melancon: In the United States the CPA credential is viewed as the right designation for top-level management personnel and accounting and business executives. In July we issued a white paper, *CPAs as CFOs: Why You Should Have a CPA in Your C-Suite*, that spoke about those roles all the way up into the boardroom. Many successful U.S. CEOs—and obviously the top CFOs—are CPAs. *(continued on page 70)*

JofA: *How does the practice of management accounting differ internationally? What can* JofA *readers learn from their peers in Canada and the United Kingdom?*

Vieweg: In today's global environment there really aren't any specific issues one of us deals with that don't affect the others—we're all in the same game. Our members need the means to translate strategy into operational terms and to make sure it fits competitively worldwide. With respect to sharing best practices, all three of us continuously look at each other's organizations and share what works with our members and their employers.

Tilley: There are new challenges all the time. Whether it's in an individual business sector or from country to country, some accountants are going to encounter problems or issues first. The most important thing we can do is share. The other thing none of us should ever lose sight of is the importance of sound financial foundations and a solid code of ethics. They are fundamental to businesses everywhere.

Charles Tilley emphasizes the importance of ethics for management accountants and says CIMA members operate under a solid code of ethics that is fundamental to business success.

Melancon: The differences are subtle. Certainly tax and compliance laws and cultural issues vary. The leading countries are exporting some of their requirements, not necessarily intentionally. For instance, some of the components of Sarbanes-Oxley have been exported to various corners of the world so businesses can participate in U.S. financial markets. Conversely, some things happening in Europe affect CPAs here. Obviously the United States and Canada have a strong business connection and many Canadian companies are listed on U.S. exchanges. The Internet also has added to the global nature of business. So the differences tend to be more subtle and the commonalities more substantive. Information sharing and learning among our three leading management accounting organizations are really what our groups are all about.

Tilley: There's much evidence that well-managed companies have higher price/earnings ratios. Therefore, one of the really important issues for developing nations is to have good financial management and good transparency. There's quite a lot we can share with those countries.

Melancon: It's also a value proposition for countries or companies that embrace ethical behavior. In developing countries management accounting can be a stabilizing factor and create value by building ethics into a corporate culture.

JofA: *How can your three organizations work together to advance the discipline of management accounting and serve the needs of accountants who practice it?*

Vieweg: We keep working together as we have been and perhaps even at another level. It's only a matter of time before the principles in Sarbanes-Oxley are enacted in Canada. Much of the work the AICPA has done related to the legislation will undoubtedly benefit our membership. We can also look at things like joint conferences and research capabilities. We already have informed our members of the relationship they can have with the AICPA by becoming international associates.

Tilley: We're all trying to do the same thing. As management accountants we should be looking at how we can be efficient. For example, it's very inefficient for us to be introducing the same CPE materials. So let's "share up" the cake and see how we can push forward together rather than using our resources individually.

Melancon: All three organizations are at the center of influence on financial management and management accounting. Together we are more effective. Over the months and years to come, we should enhance activities that permit us to leverage our resources and our actions. We can't lose sight of the importance of our members' remaining involved in our respective organizations, contributing their knowledge to the profession, because clearly that's where the leverage occurs. ■

It's no longer a matter of making a best estimate.

Valuing IP Post-Sarbanes-Oxley

BY RUSS BANHAM

Before 2002, identifying and valuing intellectual property (IP) was more art than science. But in that year Congress passed the Sarbanes-Oxley Act and FASB issued new accounting standards for measuring and reporting on intangible assets. In this high-pressure environment CPAs will find IP valuation is no longer a matter of making a best estimate.

As regulators begin to seek greater clarity in the asset values of publicly traded companies and require them to make more transparent disclosures, the onus is on CPAs to apply more scientific rigor to their IP valuations. But certifying with mathematical exactitude the full value of intangibles such as patents, brands, in-process research and other IP assets can be problematic.

This article describes the valuation issues CPAs face with intangible assets, the rules they must follow and how they can avoid some pitfalls in the search for a value that meets all requirements.

Overlooked Assets

Some 49% of companies said they relied primarily on intangible assets to create shareholder wealth, yet only 5% had a robust system to measure and track the performance of intangible assets.

Source: "Intangible Assets and Future Value," Accenture Ltd., 2003 survey of 120 senior executives, **www.accenture.com**.

VALUATION CHALLENGES

When it comes to valuing IP, there is nothing in Sarbanes-Oxley that says, "Do this or do that," says James Rigby, CPA, a managing director in the Los Angeles office of the Financial Valuation Group, a consulting firm specializing in valuation and performance issues. "What Sarbanes-Oxley does do is imply a greater responsibility for recording IP assets on the financial statements. The legislation didn't change anything in terms of what people should be doing. It just imposed greater responsibility and punishment."

Sarbanes-Oxley says companies "must be more rigorous, accurate and inclusive as far as the material effect of all assets on the bottom line, and then sign off that the numbers are on the money," agrees Gary Morris, a partner and IP specialist in the Washington, D.C., office of law firm Kenyon & Kenyon. While this level of accuracy generally includes IP, it's virtually impossible to accomplish with intangible assets such as a patent, copyright or brand name.

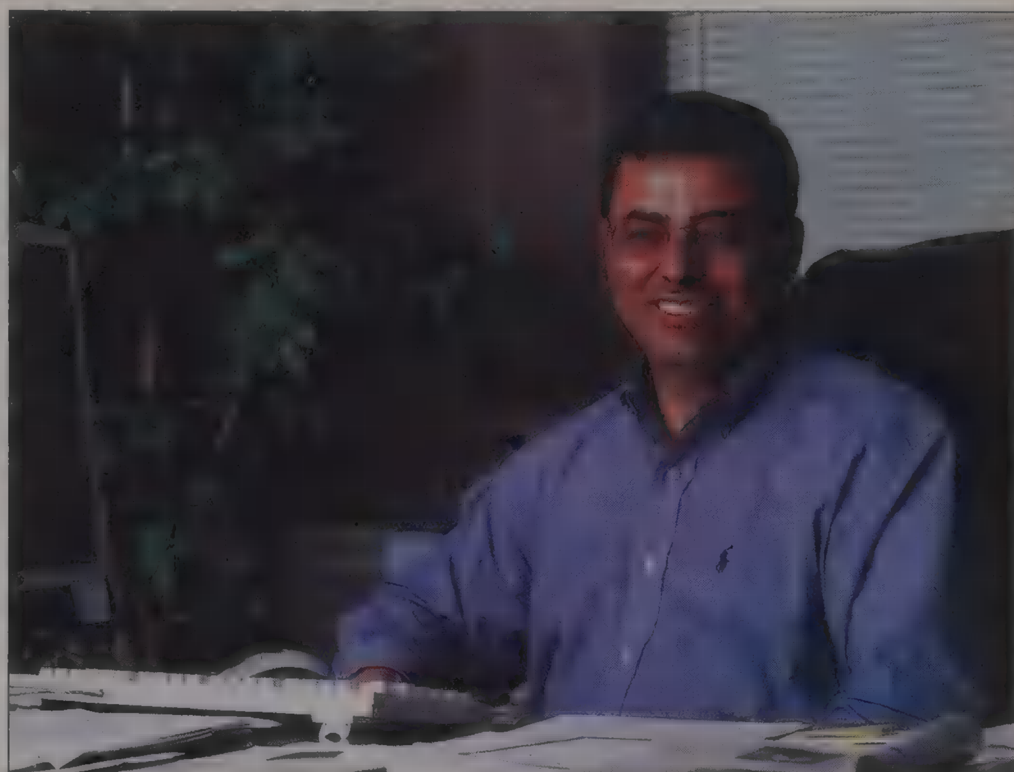
Sarbanes-Oxley and FASB Statement no. 141, *Business Combinations*, and Statement no. 142, *Goodwill and Other Intangible Assets*, converge with another trend—the increasing importance of intangibles to the value of a business. "IP has increased economic value, requires review by top executives and is garnering enhanced interest from regulators," says Edward Black, a partner and head of the IP practice group at Boston-based law firm Ropes & Gray. Twenty years ago, intangible assets weren't that important—bricks and mortar were the key assets. Today, Black says intangible assets are critical, making accurate disclosure more important.

Three sections of Sarbanes-Oxley, while not directed specifically at intellectual property, particularly affect public companies with IP that is material to their business. Section

302 requires CEOs and CFOs to certify the financial information presented in their annual and quarterly reports is accurate—fairly presenting "in all material respects" the company's financial condition. Section 404 says companies must document and certify their internal financial reporting procedures and controls. Section 409 requires them to deliver real-time reports of "material events" affecting the company to shareholders or other "stakeholders."

Sarbanes-Oxley isn't the only recent development affecting IP valuation. Statement nos. 141 (intangible asset identification upon acquisition) and 142 (annual intangible asset fair value measurement) require companies to measure and report on the financial performance of acquired intangible assets. In the wake of recent business scandals, leading accounting firms such as PricewaterhouseCoopers and Grant Thornton are urging a migration from rules-based accounting standards to a principles-based methodology, a system many foreign countries use. Principles-based standards, which use broad guidelines focusing on the spirit of an underlying principle, would reduce the complexity and gamesmanship IP valuation currently involves. CPAs would apply professional judgment to determine the fair presentation of IP value rather than rules for all possible circumstances.

Michael Mard, CPA/ABV, a managing director in the Tampa, Fla., office of Financial Valuation Group, says FASB's goal is to develop procedures that will reasonably estimate market values. "The issue with following bright-line rules-based standards is that those rules tend to multiply, ultimately becoming an exercise in checking the box, with no regard for fundamental economic forces." Principles-based standards, he says, will keep the eye on the ball—those underlying forces.



According to Michael Mard, CPA/ABV, a move to principles-based accounting standards will keep IP valuation focused on fundamental economic forces.

FUZZY FACTS

Companies value IP for three primary purposes: financial reporting; transactions (determining the value of a property to sell, buy or give to charity); and litigation (typically over unauthorized use of the IP in question). Absent specific requirements covering IP, Sarbanes-Oxley has changed the financial reporting climate in which companies value all assets. "Companies must measure, monitor and disclose the relationship between intellectual property rights and a company's financial performance, and translate changes in the scope and strength of those rights into reportable indicators of financial performance," explains Lisa Vertinsky, an associate and IP attorney with the Boston law firm Wolf, Greenfield & Sacks.

More generally, sections 302, 404 and 409 suggest CPAs need to "rethink the role of intellectual property valuations and audits in corporate strategy, as well as introduce new systems to ensure that information about IP is communicated to and understood by top decision makers, and translated into financial reports," she notes.

Influenced by Sarbanes-Oxley and FASB financial reporting requirements, a company owning IP of material value must

- Identify the assets.
- Pinpoint any changes or transactions that may affect these assets.
- Properly value the assets (critical in a merger or acquisition where the asset value appears on the balance sheet).
- Demonstrate it has adequate internal controls for managing IP assets.

For a checklist of information CPAs will find useful in valuing various types of intangible assets including copyrights, customer relationships, in-process research, know-how, patents, software, proprietary technology and trademarks, see the exhibit on pages 75–76.

While Sarbanes-Oxley didn't change the actual IP valuation process, it reaffirms the need to correctly value IP assets—and added some teeth to ensure compliance. "Sarbanes-Oxley imposes more stringent standards for accurately reporting financial matters that have a material impact on the company's financial health," says Morris. "When you have an intangible asset such as a patent or trademark, the boundaries are not as clear as with a tangible asset such as a building. When you try to describe exactly what IP you own, things get fuzzy fast."

THE VALUE OF VALUING

Statements nos. 141 and 142 also put pressure on CPAs who value IP to ensure appropriate valuation. The ac-

counting rules require breaking down acquired assets into separate categories that traditionally were lumped together into a single intangibles or goodwill reporting item. Categories include "marketing-related assets," covering trademarks, "customer-related assets" (customer lists), "contract-based assets" (licenses and employment agreements), "artistic-related assets" (photographs) and "technology-based assets" (trade secrets and patents).

> For more information on the steps to follow in valuing intangible assets using various available methods, see the checklist available online at **www.aicpa.org/download/pubs/jofa/BanhamOnline.doc**.

The rules provide a framework CPAs can use to organize intangible assets into categories and then require companies to create accurate measures for these assets that can be monitored and adjusted over time. CPAs then must incorporate these measures into the financial statements and update them periodically and when certain events—such as an acquisition—occur.

Both Sarbanes-Oxley and Statement nos. 141 and 142 raise complicated competitive issues by forcing companies to divulge IP asset values they might prefer to keep secret. "What you disclose to investors you also disclose to competitors," Rigby says. It's a matter of what is considered prudent. "If it's damaging to the company to give information to competitors, it's also damaging to the investor." Rigby says a company may not want to release all the information some investors would like. "There has to be a happy balance."

Vertinsky agrees: "Companies must balance the need to protect their proprietary information against the disclosure requirements, which means the law may sometimes trump good business judgment." Certain strategies that depend on secrecy may, in some instances, be unavailable or available only for limited times. She cites an example where a company gets a cease and desist letter from another company that says its activities are infringing on the latter's intellectual property. This could "have a big impact on your product strategy. It may be something you don't want competitors to know. At what point does this become something you have to disclose?"

At the same time, though, the disclosure requirements might interpret this information as material in the context of a 10-K filing. "You may need to disclose even though you aren't certain an actual infringement took place. The rules may accelerate the need to reveal information." Vertinsky says. Her advice, in the absence of anecdotal evidence of how the rules will be enforced, is to have a consistent set of guidelines in place for how to treat such information. She advises companies to "think carefully about the dual role those guidelines play as good for both company strategy and compliance with regulations. You want to be able to demonstrate you have internal controls in place—with input from IP counsel and management—demonstrating that you are trying to comply."

Yet another strain for CPAs who value IP is uncertainty surrounding principles-based accounting standards and their potential impact on IP. A FASB statement on fair value measurements, targeted for this quarter, will continue FASB's march toward principles-based, away from rules-based, standards, says Mard. "The forthcoming FASB statement establishes a framework CPAs can use when measuring intellectual property for financial reporting. It follows a hierarchy that centers around quoted market prices and market participation. The framework also establishes whether such assets are to be appraised on a stand-alone 'exchange' basis or 'in use' as a going concern." More information on the contents of the forthcoming statement is available at **www.fasb.org/project/fv_measurement.shtml**.

While these measurement techniques add to the transparency of management's reporting of asset values, they must be "tempered by the economic realities of managing

(continued on page 77)

EXECUTIVE SUMMARY

- **ALTHOUGH SARBANES-OXLEY SETS NO SPECIFIC** requirements for CPAs valuing intellectual property, it does put greater emphasis on accurate valuation of all assets and imposes punishments on CEOs and CFOs for failure to do so.

- **INTANGIBLE ASSETS OF ALL KINDS, INCLUDING PATENTS,** brand names, in-process research and the like, have become increasingly important to the economic value of a business. This makes it critical to accurately disclose the facts about intellectual property.

- **SARBANES-OXLEY ISN'T THE ONLY RECENT** development affecting IP valuation. FASB Statement nos. 141 (intangible asset identification upon acquisition) and 142 (annual intangible asset fair value measurement) require companies to measure and report on the financial performance of acquired intangible assets.

- **VALUING IP RAISES COMPETITIVE ISSUES** over divulging asset values companies might prefer to keep secret. Companies must balance their need to protect proprietary information with disclosure requirements.

- **CPAs CAN HELP COMPANIES CHOOSE FROM AMONG** several methods for valuing IP assets. These include the market, cost and income approaches. With the market approach, a company compares its IP assets with similar assets in the marketplace that have a known value. The cost approach values IP based on the cost to obtain it; the income approach values it based on its income-producing ability.

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Intangible Assets Information Request

A. Copyrights

______ 1. List of all copyrighted registrations.

______ 2. List of works (articles, books, paintings, etc.).

______ 3. Identify copyright names that are associated with products and/or services (such as software or report templates).

______ 4. Identify historical sale of products and/or services employing the works for the last five years.

______ 5. Projection of products and/or services that will employ the works for the next five years.

______ 6. Details of licensing transaction(s) (in or out) of any copyrighted works.

B. Customer Relationships

______ 1. Customer sales history for the last five years for the top ten customers.

______ 2. Complete customer history for the last five years (this would be for lifing).

______ 3. Financial data representing annual costs for the last five years associated with developing/soliciting new customers.

______ 4. Schedule of new customers gained in each of the last five years with sales.

______ 5. For the last five years, number of customers in a given year that failed to purchase in the following year, including those customers' sales for the prior year.

C. In-Process Research and Development

______ 1. Description of the in-process research and development.

______ 2. Description of the competitive advantages and disadvantages of the in-process research and development.

______ 3. Description of industry trends and competitive pressures that may affect the useful life of the in-process research and development.

______ 4. In light of C.2. and C.3. above, estimate the useful life of the in-process research and development.

______ 5. Cost records documenting development of the in-process research and development, including:
(a) Person hours to develop;
(b) Various technical levels of persons working on the assignment;
(c) Pay scales for individuals in C.5.b.; and
(d) Information to determine overhead rate.

______ 6. In the absence of historical cost records, estimate corporate effort to re-create the in-process research and development, including:
(a) Who would work on the assignment (employees and consultants);
(b) Pay rates for individuals in C.6.a.; and
(c) Information to determine overhead rate.

______ 7. Projection of products and/or services that will employ the in-process research and development for the next five years:
(a) Projection of revenues including licensing income for the life span of the in-process research and development;
(b) Projection of direct expenses associated with producing revenue in C.7.a.; and
(c) Summary of indirect expenses (i.e., overhead).

D. Know-How

______ 1. Description of know-how, including competitive advantages and disadvantages.

______ 2. Description of industry trends and competitive pressures that may affect the useful life of the know-how.

______ 3. In light of D.1. and D.2. above, estimate the useful life of the know-how.

______ 4. Products or services that employ the know-how.

______ 5. Historical cost records documenting development of the know-how, including:
(a) Person hours to develop;
(b) Various technical levels of persons working on the assignment;
(c) Pay scales for individuals in D.5.b.; and
(d) Information to determine overhead rate.

______ 6. In the absence of historical cost records, estimate corporate effort to re-create the know-how if it were to be developed from scratch, including:
(a) Who would work on the assignment (employees and consultants);
(b) Pay rates for individuals in D.6.a.; and
(c) Information to determine overhead rate.

______ 7. Historical sale of revenues for products and/or services employing the know-how for the last five years.

______ 8. Know-how associated with products and/or services:
(a) Provide projection of products and/or services that employ the know-how for the next five years;
(b) Project direct expenses associated with producing revenue in D.8.a.; and
(c) Obtain or develop indirect expenses (i.e., overhead).

______ 9. Details of licensing transaction(s) (in or out) of any know-how.

E. Patent

______ 1. Summary of patents held by the company.

______ 2. Copies of patent applications and patent abstracts.

______ 3. Distinguish which patents have commercial applications (i.e., are producing or are reasonably forecast to produce revenue in the future).

______ 4. Historical cost records documenting development of the patent(s):
(a) Person hours to develop;
(b) Various technical levels of persons working on the assignment;
(c) Pay scales for individuals in E.4.b.; and

(d) Information to determine overhead rate.

______ 5. Identify patents and associated products that now have or are expected to have commercial viability:
a. Projection of revenues related to patent over the life of the patent; and
b. Projection of direct expenses associated with producing revenue in E.5.a.

______ 6. Comment on the possibility of extending patent protection beyond statutory life of patent.

______ 7. Details of licensing transaction(s) (in or out) of any patents.

F. Software

______ 1. Describe the function of the software.

______ 2. For Cost Approach:
(a) If available, please provide historical cost records documenting development of the software, including:
(1) Person hours to develop;
(2) Various technical levels of persons working on the assignment;
(3) Pay scales for individuals in F.2.a.(2); and
(4) Information to determine overhead rate.
(b) In the absence of historical cost records, estimate effort to recreate the software if it were to be developed from scratch, including:
(1) Who would work on the assignment (employees and consultants);
(2) Pay rates for individuals in F.2.b.(1); and
(3) Information to determine overhead rate.

______ 3. Lifing/Obsolescence:
(a) What was the expected useful life at inception and at valuation date. Obtain support for estimate;
(b) When was software actually placed in use;
(c) Describe internal development that may extend life;
(d) Describe internal development of replacement software that might shorten life; and
(e) Describe external factors that may affect life.

______ 4. For Income Approach:
(a) Obtain historical revenues applicable to software;
(b) Project revenues including licensing income for lifespan of software;
(c) Project direct expenses associated with producing revenue in F.4.b.;
(d) Obtain or develop indirect expenses (i.e., overhead); and
(e) Identify expenses, direct and indirect, not associated with acquired software.

G. Proprietary Processes/Products Technology

______ 1. Description of the proprietary process/product technology.

______ 2. Description of competitive advantages and disadvantages of the proprietary process/product technology.

______ 3. Description of industry trends and competitive pressures that may affect the useful life of the proprietary process/product technology.

______ 4. In light of G.2. and G.3. above, estimate the useful life of the proprietary process/product technology support.

______ 5. Historical cost records documenting development of the process/product technology:
(a) Person hours to develop;
(b) Various technical levels of persons working on the assignment;
(c) Pay scales for individuals in G.5.b.; and
(d) Information to determine overhead rate.

______ 6. In the absence of historical cost records, estimate effort to recreate the process/product technology if it were to be developed from scratch:
(a) Who would work on the assignment (employees and consultants);
(b) Pay rates for individuals in G.6.a.; and
(c) Information to determine overhead rate.

______ 7. Historical sale of products and/or services employing process/product technology for the last five years.

______ 8. Projection of products and/or services that employ the process/product technology for the next five years:
(a) Projection of revenues including licensing in come for the lifespan of process/product technology;
(b) Projection of direct expenses associated with producing revenue in G.8.a.; and
(c) Obtain or develop indirect expenses (i.e., overhead).

______ 9. Details of licensing transaction(s) (in or out) of any technology.

H. Trademark/Trade Name

______ 1. List of all trademark/trade name registrations.

______ 2. List of trademark/trade names that are not registered.

______ 3. Identify trademarks/trade names that are associated with products and/or services.

______ 4. Identify historical sale of products and/or services employing trademarks/trade names for the last five years.

______ 5. Projection of products and/or services that employ the trademarks/trade names for the next five years.

______ 6. Details of licensing transaction(s) (in or out) of any trademarks/trade names.

Disclaimer Excluding Any Warranties: *This checklist is designed to provide guidance to analysts, auditors and management but is not to be used as a substitute for professional judgment. These procedures must be altered to fit each assignment. The practitioner takes sole responsibility for implementation of this guide. The implied warranties of merchantability and fitness of purpose and all other warranties, whether expressed or implied, are excluded from this transaction and shall not apply to this guide. The Financial Valuation Group shall not be liable for any indirect, special, or consequential damages.*

such assets in a market environment that moves up and down and from moment to moment," Mard adds. "The regulatory application of fair value may be different from the economic reality." The result, however, will be more information for the public and for shareholders.

Against this backdrop, valuators are attempting to add more discipline to identifying and valuing IP assets. "There is no such thing as an easy valuation," says Ethan Horwitz, chairman of the IP group in the New York office of national law firm Goodwin Proctor. "Valuation is half art and half science. You can get pretty close to a proper valuation, but you're never going to get a firm number the way you could with publicly traded stock." Horwitz says formulas are difficult to rely on and IP valuation decisions are "all over the place," with any two experts likely to have very different views.

BEST PRACTICES

The first step CPAs should take in valuing IP is to systematically identify the relationship between a company's intangible assets and its financial performance. "Decision makers need to understand how intangible assets relate to the company's current and future financial performance and operation," says Vertinsky. "They must appreciate the law and economics of IP development, acquisition and enforcement strategies, and be able to translate information about the strength and scope of IP rights into reportable financial data." For example, she says, when a court rules a company's patent is invalid, the business must evaluate the ruling in terms of its likely impact on profitability. This will turn on factors such as whether the patent rights were generating license revenue or preventing third parties from producing competitive products, thus supporting high prices and profit margins the company can no longer sustain.

According to Morris, no matter how broad and impressive a patent may be, "it's no good if it is proved invalid." That means CPAs have to look at how a patent was procured and the state of the art at the time the products allegedly were invented. Morris advises CPAs to "scrutinize the scope of the claims and then have someone who knows patent law give them the once-over. What it says on its face may not be its actual scope." Then apply all this to how the business intends to use the patent.

Attorney Lisa Vertinsky says companies must balance the need to protect proprietary information against disclosure requirements. In some instances the law will trump good business judgment.

Horowitz says companies must bring a competent patent attorney to the table to help identify and assess IP asset value. "The best practice is to put a patent attorney, a CPA and a technology person in a room and have them work out scenarios whereby the patent would bring value to the company," he says. "The technology person can explain how the IP is used, the CPA can describe the value and the patent attorney can focus on the exclusivity. You need all three to come to a decision."

Third-party audits of IP values are another best practice. Such audits iden-

AICPA RESOURCES

Publications

- *Valuation for Financial Reporting: Intangible Assets, Goodwill, and Impairment Analysis—SFAS 141 and 142*, John Wiley & Sons, (# WI237531P0200DJA).
- *Valuation of Intellectual Property and Intangible Assets* (3rd ed.), John Wiley & Sons (# WI362816P0000DJA).

CPE

Valuing Goodwill and Intangible Assets, self-study course, (text, # 731263JA).

For more information, to make a purchase or to register, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

Credential

Accredited in Business Valuation (ABV)

For more information, see **http://bvfls.aicpa.org**, click on the Membership tab and then click on "enter into our Accredited in Business Valuation (ABV) Program."

tify IP assets including issued patents, registered trademarks, copyrights, trade secrets and IP acquired or licensed from third parties. They are particularly important in a merger or acquisition, Bishop says, "where you want to be assured the price you're paying for the assets is commensurate with the value." The IP audit also may include an evaluation of the procedures the company uses to maintain the assets and avoid unauthorized use of others' IP rights.

Kevin Haggerty, CPA, senior director of internal audit at QuadraMed Corp., a Reston, Va.-based medical software company with $140 million in annual revenues, says he gets help from third-party financial valuators, who come in once a year to assess the value of the company's software licenses, patents and other IP assets. They do all the evaluation and testing and document the result.

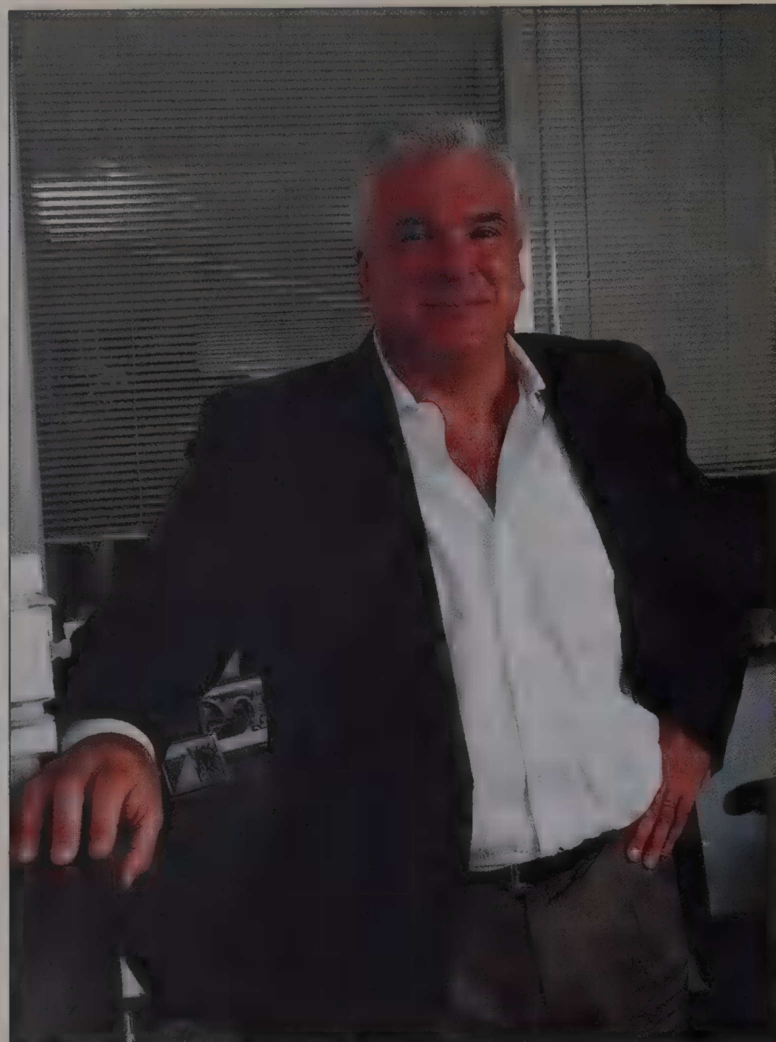
Once a company has complied with Statement nos. 141 and 142 and separated IP assets into meaningful portfolios, it then must decide on a valuation methodology. There are several approaches, among them the market approach, the cost approach and the income approach. In the first, a company's IP assets are compared with assets in the marketplace that have a known value. "Much like valuing real estate, you find a comparable property that has a known value and compare it to yours." The cost approach essentially values IP based on the cost to obtain it. This is either the purchase price or what the company paid the engineers and attorneys to come up with the idea and file the patent application. The income approach bases value on the IP's income-producing ability. There is no perfect method. The goal is to be consistent.

CPAs should recommend companies develop processes to collect and verify IP-related data. Historically, companies have not regularly kept all the records needed to value intangibles, so many will have to go back and recreate the data from their accounting information systems, Rigby says. That may mean modifying the enterprise resource planning system to capture intangible assets in the same way it does tangible assets.

Ron Epstein, CEO of IPotential, a San Mateo, Calif.-based IP strategy consultant, advises "documentation and more documentation" to back up IP value assessments.

PRACTICAL TIPS

- The best valuations of IP assets come from cross-disciplinary teams that include a patent attorney and a technology person as well as a CPA.
- Consider a third-party audit to help identify IP assets and evaluate the procedures the company uses to maintain them.
- Implement processes to routinely collect and verify IP-related data, even if that means modifying the enterprise resource planning system to capture intangible assets.



Kevin Haggerty, CPA, says his company, QuadraMed Corp., brings in third-party financial valuators once a year to assess its software licenses, patents and other IP assets.

"Sarbanes-Oxley is about disclosure," he emphasizes. "In corporate 10-Ks and 10-Qs, there is a 'risk factor' section that offers the opportunity to have lawyers write a good explanation of how you approached valuing the IP, highlighting any areas you are not absolutely sure of. You're telling regulators 'we're doing our best' to appropriately disclose."

Handling IP correctly extends beyond valuation issues. Senior executives must manage a company's IP rights based on their importance to the organization's overall financial health and must consider their own liability if the numbers don't stack up. "CEOs and CFOs must feel comfortable when they certify a report that says the company's IP assets are fairly represented," says Jody Bishop, senior associate and IP specialist in the Dallas office of law firm Fulbright & Jaworski.

GET READY FOR THE FUTURE

How can CPAs prepare for the possible impact principles-based accounting standards will have on IP valuation? Vertinsky advises networking with companies abroad that already have such rules in place. "It's better to recognize in advance what you will face on your balance sheet if you're anticipating a merger or acquisition than to face it all at once," she says. "Lean on an expert in those parts of the world that already understand the standards." ■

PHOTOGRAPH BY DENNIS BRACK/BLACK STAR

AICPA Agenda: Helping in Time of Need

"All of us at the AICPA share the deep sadness and concern the entire nation feels over the devastation caused by Hurricanes Katrina and Rita. Our hearts go out to the hundreds of thousands of Americans whose lives have been forever changed, including the thousands of AICPA members and their families living in areas affected by these disasters.

"The CPA profession has responded to these crises in a very decisive way to bring to bear its expertise regarding financial matters to help the victims. The AICPA has launched a number of efforts to support our members in this extraordinary time. The items below detail some of the initiatives already under way."

—Barry C. Melancon, President and CEO

Online Disaster Recovery Resource Center
The AICPA has established an online Disaster Recovery Resource Center (**www.aicpa.org/news/2005/disaster_recovery_resources.htm**). Visit it for up-to-date information, useful links to other Web sites and a wide range of practical tools. The center includes resources for members to use to assist their employers and clients, as well as practice management guidance for firms directly affected by Hurricanes Katrina and Rita.

CPA Firms Assisting Affected Members With Office Space and More
The AICPA and PCPS have launched a Firm Volunteer Center to allow CPA firms to provide office space and other resources to CPAs displaced by Hurricanes Katrina and Rita. Displaced CPAs can find contact information at the center for firms wishing to volunteer resources or assist those in need. If you are a CPA in need of assistance or a CPA firm that wants to help, go to **http://pcps.aicpa.org/Community/Hurricane+Katrina.htm**. Volunteers are offering office space, housing, office supplies, technology support, hosting and/or software, temporary hiring of staff, disaster recovery assistance, help in reaching clients of affected firms and help with filings.

Disaster Recovery Guides, Mobilization Kit and Other Resources
Disaster Recovery: A Guide to Financial Issues was developed by the AICPA Personal Financial Planning (PFP) team to help individuals and families in the days, weeks and months following a disaster when they are most in need and often vulnerable to financial challenges. The guide, produced by the National Endowment for Financial Education, the AICPA and the AICPA Foundation, is distributed by participating local chapters of the American Red Cross.

As part of this effort, the AICPA developed the Disaster Recovery CPA Mobilization Kit (**www.aicpa.org/financialliteracy/Financial_Toolkits/Guide_to_financial_Issues_Toolkit.asp**) to support state societies and CPAs in their volunteer outreach to those affected by disaster. The kit focuses on the pro bono services CPAs can offer in moments of crisis and includes a press release template, bylined article and PowerPoint presentation. The AICPA Tax Section's *Disaster Area Practice Guide* (**http://tax.aicpa.org/Resources/Disaster+Area+Tax+Guide.htm**), also available, has been updated to include guidance for victims of Hurricanes Katrina and Rita and has links to IRS and other tax-related disaster recovery resources.

"Ask the Money Doctor" to Address Hurricane-Related Financial Questions
The AICPA's 360 Degrees of Financial Literacy Program has modified its Web-based discussion forum, "Ask the Money Doctor," to allow CPA financial planners from other parts of the country to answer inquiries from people who were affected by the hurricanes. For access to this resource and to view a list of frequently asked questions, visit **www.360financialliteracy.org/Ask+The+Money+Dr.htm** (or **www.askthemoneydoctor.com**).

AICPA and NASBA Ask State Boards to Expedite Reciprocity Requests
The AICPA and NASBA sent a joint letter to each state board of accountancy requesting they expedite practice privilege requests from CPAs and firms that have been affected by Hurricanes Katrina and Rita and are seeking to practice in their state. Numerous boards of accountancy have already contacted NASBA to report they have plans in place to facilitate requests and/or are planning to meet to discuss this initiative.

The AICPA also has compiled state licensing information, including state board of accountancy and state CPA society contact information, to be used for those licensees who are seeking practice privileges in other states. For more information, and to read the full text of the joint letter, visit **www.aicpa.org/news/2005/AICPA_and_NASBA_Ask_State_Boards.htm**. ■

Never underestimate the absolute necessity of trust.

The Virtues of Volunteering

BY KATHRYN A. FORBES

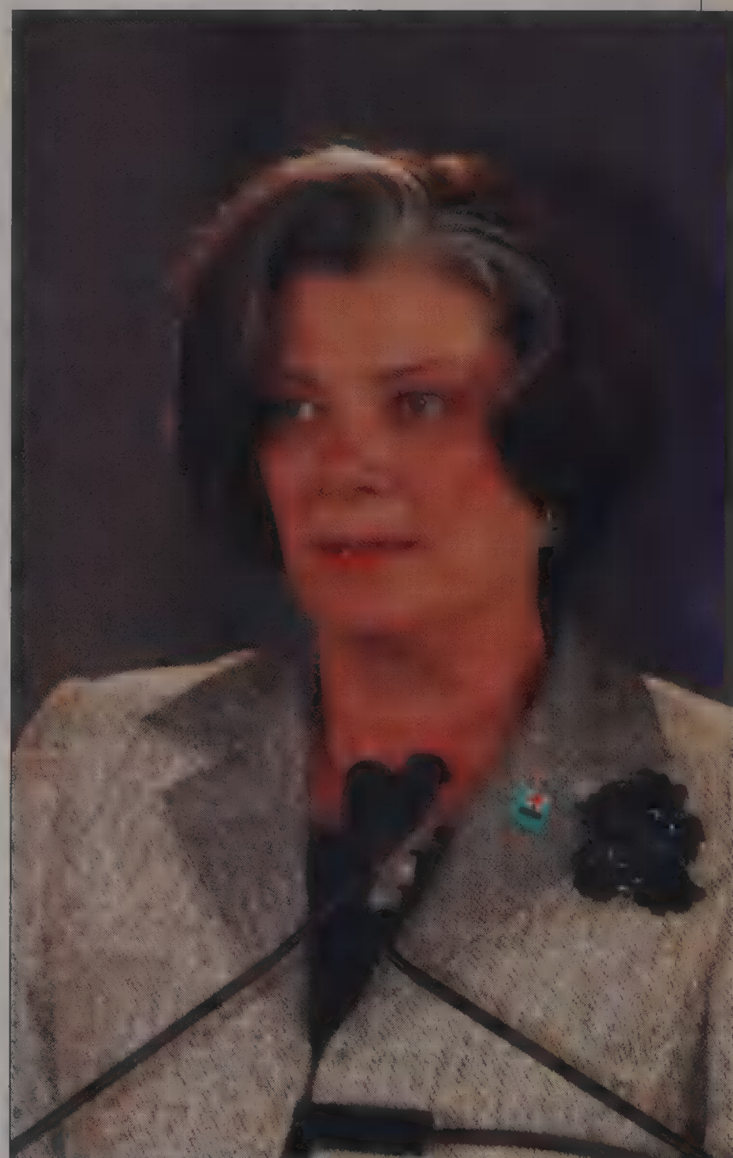
I was recruited to the American Red Cross by a former member of this council, Ron Pitman, who asked whether I'd chair an audit committee meeting at my local chapter. I didn't believe I had the time, but felt one meeting was doable. Well, we never can anticipate what events will shape our lives. I had no idea that American Red Cross meeting would last 25 years and take me to 49 states and four continents.

Being involved in the largest and most well-known international charity, one cannot underestimate the absolute necessity of trust. The American Red Cross, as all charities, must have donors' trust if it is to receive funding. Services are delivered only if volunteers trust they will be treated fairly and with respect while doing meaningful work, and blood donors must trust that giving blood is safe and that it will be distributed properly.

When one sees pictures of the American Red Cross doing its work, they usually are of a disaster worker helping a family that has just lost its home or had a member saved by the gift of life—blood. But in 25 years I have yet to see a public service announcement showing an internal auditor looking at internal controls, a CFO preparing financial statements or an external auditor working with an American Red Cross exec and an audit committee to make operations more efficient. Yet you are key to the American Red Cross's retention of its most important asset—the public's trust.

Many of you know that former AICPA board chair Stu Kessler is always cam-

Kathryn A. Forbes, CPA, executive vice-president and CFO of eTec, national chair of Volunteers of the American Red Cross and president of the AICPA Foundation, won a 2004 AICPA Public Service Award. This article is from the acceptance speech she delivered before the AICPA governing council in May.



Kathryn A. Forbes, CPA, as vice-chair and audit committee chair of the American Red Cross's National Board of Governors, managed $1 billion in donations received after September 11, 2001.

paigning for a television program about CPAs. Well, I have the first episode. It takes place on that horrific day, September 11, 2001, when all our lives changed dramatically. The episode star is Tim Holmes, the American Red Cross general auditor. Although not reported, the American Red Cross lost vehicles and had rescue workers running for their lives when the towers fell. Within 48 hours, while bomb threats were received at the recovery center, American Red Cross internal auditors were on site working to ensure that $1 billion, the largest single domestic donation, was being accounted for and distributed properly.

The supporting cast involves our external auditor, KPMG LLP, who consulted with the audit committee and management on a weekly basis for six months on how to best coordinate the activities of more than 1,000 chapters.

My guess is that many of you in this room would also appear in this episode, since more than 500 local firms perform audits at the chapter level. You were all there in the first week working with American Red Cross units in your community, ensuring that all was well. You sent us your best and helped us develop better financial systems.

The next episode would feature Nita Clyde from Texas. When approached, Nita agreed to take on the chairmanship of the September 11 Oversight Commission, whose responsibility was to see that over $300 million in funds was distributed properly. Nita has never flinched, earning the respect of all, and today still works tirelessly to see the funds are used appropriately.

What is the result of all these CPAs giving their very best when times are at their very worst? Well, last December 26, when the horrible tsunami hit, again the world responded with unprecedented generosity, and your work paid off. People worldwide voted with their dollars and gave the International and American Red Cross and Red Crescent movements almost $1.4 billion.

The American Red Cross was one of only two charities that received an A-plus rating from a watchdog organization on its handling of the tsunami disaster donations. As much as the disaster workers in the field, it is the hundreds of CPA professionals who helped the American Red Cross process and distribute donations that resulted in that A-plus rating.

Most television shows have spinoffs and I have an idea for one as well. It would star Barry Melancon, who challenged us to look past the numbers. I took that advice to heart. Dr. Robert Ashcraft, an outstanding professor from Arizona State University (ASU) and a fellow American Red Crosser, and I were expressing our frustration about the quality of boards and executives in the nonprofit sector. We concluded there needed to be a place where those wanting to serve on boards of nonprofits could go for training in partnership with executive directors. With help from the W.K. Kellogg Foundation, ASU's Center for Nonprofit Leadership and Management was born. Thank you, Barry, for urging us on.

At the American Red Cross an impressive 95% of the work is done by volunteers, and our research shows that most people decide to volunteer when asked by a friend. So, for all of you who are volunteering in your community, thank you. For all those not currently volunteering, I am asking you to please volunteer at a local charity. Your community will be a better place if your skills are put to work. There isn't a charity that won't be stronger if there's a CPA serving on its board of directors. Encourage your staff to volunteer; it just might change their lives in ways they never imagined. Again, thank you so much. ■

VOLUNTEER CENTRAL

For information on resources CPAs can use to help victims recover from hurricanes and other disasters, go to **www.aicpa.org/news/2005/disaster_recovery_resources.htm**.

Spreadsheets now can solve tougher calculations.

Double-Teaming In Excel

BY JUDITH K. WELCH, LOIS S. MAHONEY
AND DANIEL R. BRICKNER

Creating a spreadsheet to calculate depreciation expenses for a single property class is a piece of cake for most accountants using Excel's LOOKUP function (see "Make Excel a Little Smarter," *JofA*, Jul.03, page 73). But many CPAs might scratch their heads for a solution if the exercise contained more than one property class. Read on and we'll show you how to perform that difficult calculation by teaming LOOKUP with MATCH.

As you can see from exhibit 1, below, the solution for five-year property class assets is solved simply with =VLOOKUP(F5,A$5:B$11, 2,FALSE).

But if we expanded the problem to include seven-year assets, the necessary data would be dependent on the intersection of rows (the age of the asset) and columns (its property class). Clearly LOOKUP can't perform the data extraction on its own—but exhibit 2, page 84, shows how to solve the problem by embedding MATCH inside the LOOKUP function.

Let's create that command in the formula bar (*fx*). As you know the LOOKUP function extracts data from one area of a spreadsheet and uses them in another. If the data are organized horizontally, we'd use HLOOKUP; and if

> **Key to Instructions**
> To help readers follow the instructions in this article, we use two different typefaces:
> ■ **Boldface type** is used to identify the names of icons, agendas and URLs.
> ■ Sans serif type shows commands and instructions users should type into the computer and the names of files.

Exhibit 1

I5 *fx* =VLOOKUP(F5,A$5:B$11,2,FALSE)

	A	B	C	D	E	F	G	H	I	J
1	MACRS DEPRECIATION RATE				ASSET DEPRECIATION SCHEDULE					
2										
3		Property class		Year for computation:	2004					
4	Age	Five		Name	Year of purchase	Age	Class	Cost	Rate	Depreciation
5	1	20.00%		Light truck	1999	6	Five	$ 20,000	5.76%	$ 1,152
6	2	32.00%		Copier	1998	7	Five	$ 4,000	0.00%	$ -
7	3	19.20%		Computer	2002	3	Five	$ 15,000	19.20%	$ 2,880
8	4	11.52%								
9	5	11.52%					Total			$ 4,032
10	6	5.76%								
11	7	0.00%								

Exhibit 2

K4 =VLOOKUP(H4,B$3:D$11,MATCH(I4,B$3:D$3,0),FALSE)

	A	B	C	D	E	F	G	H	I	J	K	L
1		MACRS DEPRECIATION RATE				ASSET DEPRECIATION SCHEDULE						
2		PROPERTY CLASS				Year for computation:		[illegible]				
3		Age	Five	Seven		Name	Year of purchase	Age	Property class	Cost	Rate	Depreciation
4		1	20.00%	14.29%		Light Truck	1999	6	Five	$20,000	5.76%	$ 1,152
5		2	32.00%	24.49%		Copier	1998	7	Five	$ 4,000	0.00%	$ -
6		3	19.20%	17.49%		Desk	1995	10	Seven	$ 1,500	#N/A	#N/A
7		4	11.52%	12.49%		Computer	2002	3	Five	$15,000	19.20%	$ 2,880
8		5	11.52%	8.93%		File Cabinet	2003	2	Seven	$ 500	24.49%	$ 122
9		6	5.76%	8.92%								
10		7		8.93%					Total			#N/A
11		[illegible]		4.46%								

they're vertical, as in this example, we'd use VLOOKUP, which contains four parts:

1 2 3 4

=VLOOKUP(lookup_value,table_array, col_index_num,range_lookup)

Assume we want to calculate depreciation expense under the modified accelerated cost recovery system (MACRS) for assets with a five-year property class. Exhibit 1 shows how the LOOKUP command could extract the appropriate depreciation rate from a MACRS rate table and place it in cell I5:

I5=VLOOKUP(F5,A$5:B$11,2,FALSE)

(*Editor's note:* Excel's **Function Wizard** could be recruited to develop the formula. To open the wizard, click on **Insert**, **Function**, which evokes a pop-up screen that will walk you through the process.)

Formula details:

- The choice of VLOOKUP shows the table is organized vertically.
- *Lookup_value* = F5 commands Excel to look up the age of the asset (six years) in the first column of the table.
- *Table_array* = A$5:B$11 is the cell range of the table. Notice the absolute cell reference ($) should be used before copying this formula to other cells.
- *Col_index_num* = 2 retrieves the depreciation rate from the second column of the table.
- *Range_lookup* = FALSE finds an exact age match in the table. (For applications in which exact matches are not necessarily sought, such as when the variable in question covers a range of values, the range_lookup would be entered as TRUE, which is the default. In such instances, Excel will find the largest value less than or equal to the lookup_value; the data in the table therefore must be presented in ascending order.)

Now, if we add seven-year-property class assets, the necessary data for the depreciation expense calculations will be dependent on the intersection of rows (the age of the asset) and columns (its property class). That will require the addition of the MATCH function to find the intersection of two data points in a table—in our example, the age and class of an asset. We'll use MATCH in the col_index_num position of the LOOKUP function. MATCH has three required elements:

1 2 3

=MATCH(lookup_value,lookup_array,match_type)

Details:

- *Lookup_value* = The value you want to match in your table. It can be a number, text or logical value.
- *Lookup_array* = The range in the table containing the value you're seeking.
- *Match_type* = The number, -1, 0 or 1, that specifies how Excel matches the lookup_value with values in the lookup_array. If match_type is 1, MATCH finds the largest value that is less than or equal to lookup_value.

The lookup_array must be placed in ascending order: -2, -1, 0, 1, 2; A-Z; and FALSE, TRUE. If match_type is 0, MATCH finds the first value that is exactly equal to lookup_value. The lookup_array can be in any order.

If match_type is -1, MATCH finds the smallest value greater than or equal to lookup_value. The lookup_array must be placed in descending order: TRUE, FALSE; Z-A; and 2, 1, 0, -1, -2 and so on. If match_type is omitted, Excel assumes it's 1.

Now let's create the spreadsheet with VLOOKUP and MATCH in column K to determine the proper depreciation expense rate. VLOOKUP combines information from two different sections of the worksheet: Each asset's age and depreciation class are contained in columns H and I in the asset depreciation schedule and the MACRS table in B3 through D11. MATCH tells VLOOKUP what column to go to in the table to find the match (intersection) between the age and class of the asset.

Here's the formula to put in K4 to automatically extract the rate for a six-year-old asset in the five-year-class category:

K4=VLOOKUP(H4,B$3:D$11,MATCH(I4,B$3:D$3,0),FALSE).

Details:

- *Lookup_value* = H4 looks up the age of the asset in the first column of the table.
- *Table_array* = B$3:D$11 is the cell range of the table.

- *Col_index_num* = MATCH(I4,B$3:D$3,0)
- *Lookup_value* = I4 looks up the asset class (Five) in the table.
- *Lookup_array* = B$3:D$3 looks for a property class match in the first row of the table. Be sure the first cell reference in this row corresponds to the first column of the table. Be careful not to use C3.
- *MATCH_type* = 0 to find an exact match of the asset class in I4.
- *Range_lookup* = FALSE seeks an exact match of the age and class of the assets in the table. If there is no exact match, Excel will return an error message (#N/A).

Important: The item to be looked up (in this example, age) should be in the first column of the table. The item to be matched (in this example, property class) should be in the first row of the table.

SERIES OF EVENTS

When you execute the command in K4, Excel refers to the table, looks up the age of the asset and matches the appropriate property class. It then places the appropriate depreciation rate of 5.76% for the light truck in that cell (exhibit 2).

If Excel finds a match but there is no depreciation rate listed for the class and life of the asset, it returns a value of 0.00% (see K5) because it concludes the asset is fully depreciated after six years. If the age and/or class of the asset (columns H and I) doesn't exist in the table, Excel will return the #N/A error message in K6 and will not allow you to perform calculations on ranges that contain this error.

To resolve the range-error problem, we'll add the ISNA and IF functions to the formula. ISNA is written as =ISNA(value), where *value* refers to the contents of a cell. The function returns a value of TRUE if the cell content is #N/A and FALSE if it isn't. Adding this function to the front of the LOOKUP formula results in this command:

K4=ISNA(VLOOKUP(H4,B$3:D$11,
MATCH(I4,B$3:D$3,0),FALSE)).

The value in the cell in column K now will read TRUE rather than #N/A if the LOOKUP function fails to find an exact match; or it will read FALSE, instead of listing the depreciation rate, if it does find an exact match.

Now we need to add an IF function to convert TRUE so Excel can perform computations and convert FALSE to the identified depreciation rate for the match. For that we'll use the IF function, which contains three parts:

1 2 3
=IF(logical_test, value_if_true, value_if_false)

Details:

- *Logical_test* = Value or expression that evaluates to TRUE or FALSE. In our example, if ISNA finds the error value of #N/A, it returns a TRUE value; if not, it returns a FALSE value.
- *Value if_true* = Value returned if the logical_test is TRUE. For example, if the logical_test above is TRUE, the cell can accept a number or text because Excel can sum a data column with either of them in it.
- *Value_if_false* = Value returned if the logical_test is FALSE. In our situation, if the logical_test is FALSE, we will want the depreciation rate to be placed into column K.

Here is the new formula for K4 to automatically insert either the depreciation rate or a message if it finds no match for both the age and class:

K4=IF(ISNA(VLOOKUP(H4,B$3:D$11,
MATCH(I4,B$3:D$3,0),FALSE)),0,VLOOKUP
(H4,B$3:D$11,MATCH(I4,B$3:D$3,0),FALSE)).

Although it may look complicated, the formula is just a repeat of the VLOOKUP and MATCH formulas with a couple of adjustments. The spreadsheet now will look like exhibit 3, below.

By linking MATCH, ISNA and IF functions with LOOKUP we have created a depreciation schedule that automatically inserts the appropriate rate for each asset in column K and highlights input errors by noting when an asset's age, combined with its matched class, doesn't exist in our MACRS table. We also can now calculate depreciation expense for each individual asset and then sum these amounts in our asset-depreciation schedule. All these functions are handy enhancements to LOOKUP that can help you use Excel more effectively. ■

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Exhibit 3

K4 =IF(ISNA(VLOOKUP(H4,B$3:D$11,MATCH(I4,B$3:D$3,0),FALSE)),0, VLOOKUP(H4,B$3:D$11,MATCH(I4,B$3:D$3,0),FALSE))

	A	B	C	D	E	F	G	H	I	J	K	L
1		MACRS DEPRECIATION RATE				ASSET DEPRECIATION SCHEDULE						
2			Property class			Year for computation: 2004						
3		Age	Five	Seven		Name	Year of purchase	Age	Property class	Cost	[illegible]	Depreciation
4		1	20.00%	14.29%		Light Truck	1999	6	Five	$20,000	5.76%	$ 1,152
5		2	32.00%	24.49%		Copier	1998	7	Five	$ 4,000	0.00%	$ -
6		3	19.20%	17.49%		Desk	1995	10	Seven	$ 1,500	0.00%	$ -
7		4	11.52%	12.49%		Computer	2002	3	Five	$15,000	19.20%	$ 2,880
8		5	11.52%	8.93%		File Cabinet	2003	2	Seven	$ 500	24.49%	$ 122
9		[illegible]	5.76%	8.92%								
10		7		8.93%					[illegible]			$ 4,154
11		[illegible]		4.46%								

Technology Q&A

Make Excel speak faster…Expand weekend boxes in Outlook calendar… Customize keyboard shortcuts for Word…Enter several sets of numbers in one Excel cell…Out, out, green triangles…Shortcuts

BY STANLEY ZAROWIN

Key to Instructions

To help readers follow the instructions in this article, we use two different typefaces:

- **Boldface type** is used to identify the names of icons, agendas and URLs.
- Sans serif type shows commands and instructions users should type into the computer and the names of files.

MAKE EXCEL SPEAK FASTER

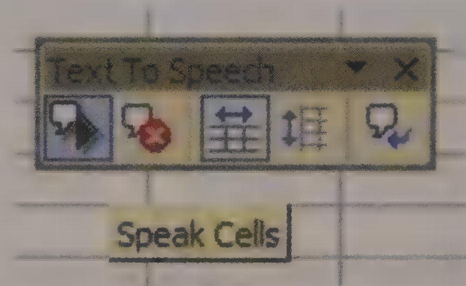
Q. A couple of years ago you described how to program Excel to read aloud the numbers in worksheets (*JofA*, Dec.03, page 89). That tip has saved me many hours of work. Can you help me get Excel's voice to speak faster so I can save even more time?

A. Sure, but before I do, let me repeat how to evoke Excel's voice for those who missed the column. You must have computer speakers and Excel 2002 or later.

Click on **Tools**, **Speech** and **Show Text to Speech Toolbar**, bringing up this toolbar:

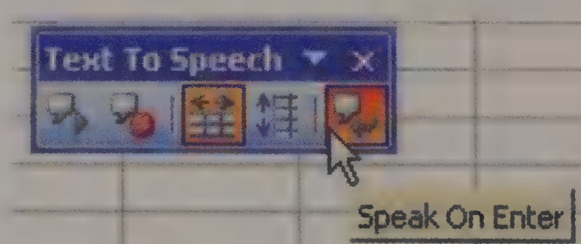
Notice there are five icons; each controls a different read-back function. Pass your cursor over each icon and an explanation of what it does will appear. Starting at the left, the first (see screenshot top right) orders Excel to read the numbers in the cell—hesitating a second or so between cells. If the cell contains a formula, it will not read the formula, just the resultant number, unless you press Ctrl+` (grave accent).

The second icon halts the process. The third and fourth control whether the automatic reading moves

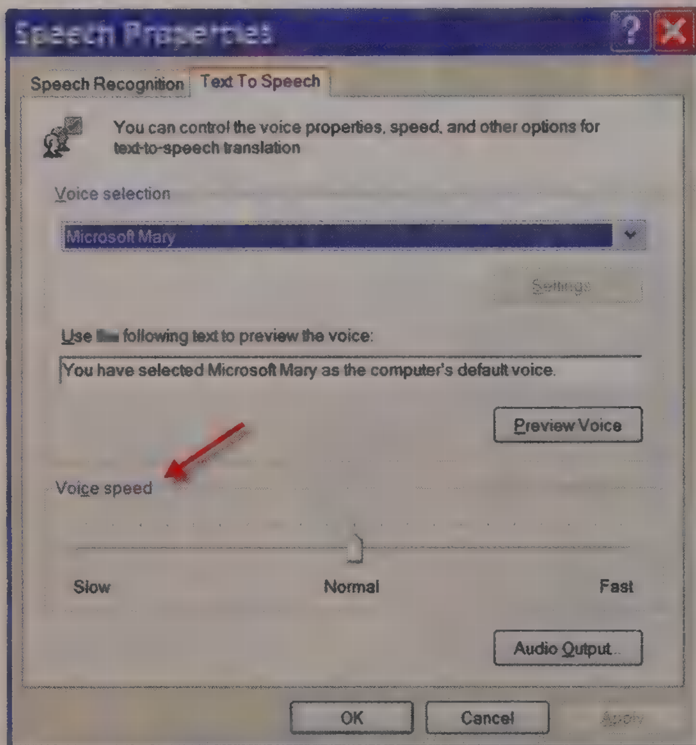


across a row or down a column. To program a cell to speak only after you press Enter, click on the fifth and final icon (see screenshot below).

Caveat: Excel provides incomplete clues about turning off its voice. If you click on the far right icon (**Speak On Enter**), you'll see it: Each click on it toggles the speaking function on or off. But the only alert you get that it's on or off is Excel's *spoken* message, so listen carefully. The text doesn't change: The text continues to read **Speak On Enter**.



Now I'll describe how to change the speech speed. Click on **Start**, **Settings**, **Control Panel**, **Speech** and then on the **Text To Speech** tab, as shown on page 88.



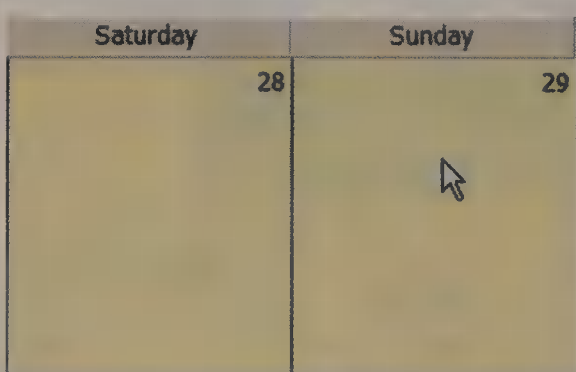
Adjust the slider under **Voice speed** toward **Fast** and then click on **OK**.

EXPAND WEEKEND BOXES IN OUTLOOK CALENDAR

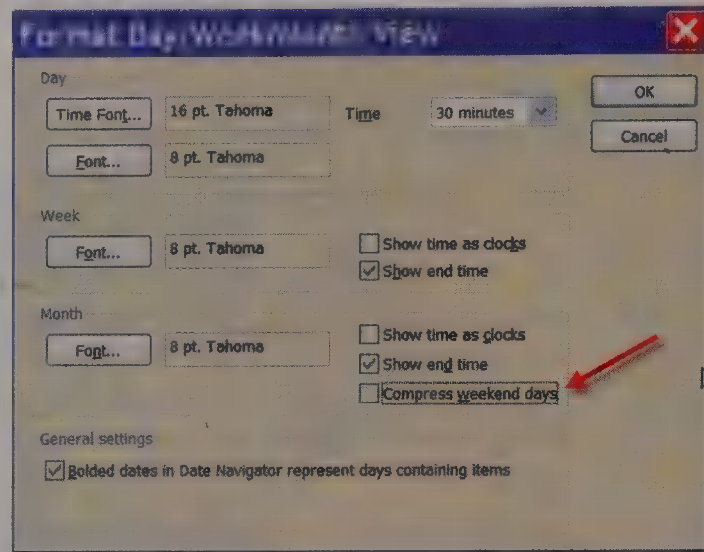
Q. My Outlook calendar has Saturdays and Sundays sharing a single box that's too small to list several activities. Is there a way to give each its own box?

A. To go from this…

…to this…



…right-click in any free area of the calendar and click on **Customized Current View** and **Other Settings** to get this screen:



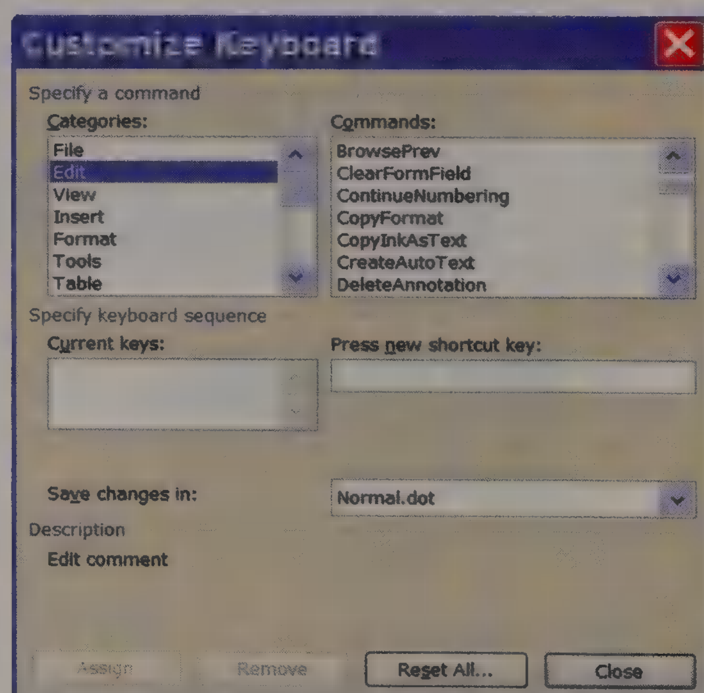
Remove the green check next to **Compress weekend days** and click on **OK**. That will do it.

CUSTOMIZE KEYBOARD SHORTCUTS FOR WORD

Q. Call me old-fashioned, but I hate the mouse. I'd much rather use keyboard combinations to activate commands. However, some of the Word commands I frequently use don't have key combinations. Any ideas?

A. You can create your own or even change the existing default combinations.

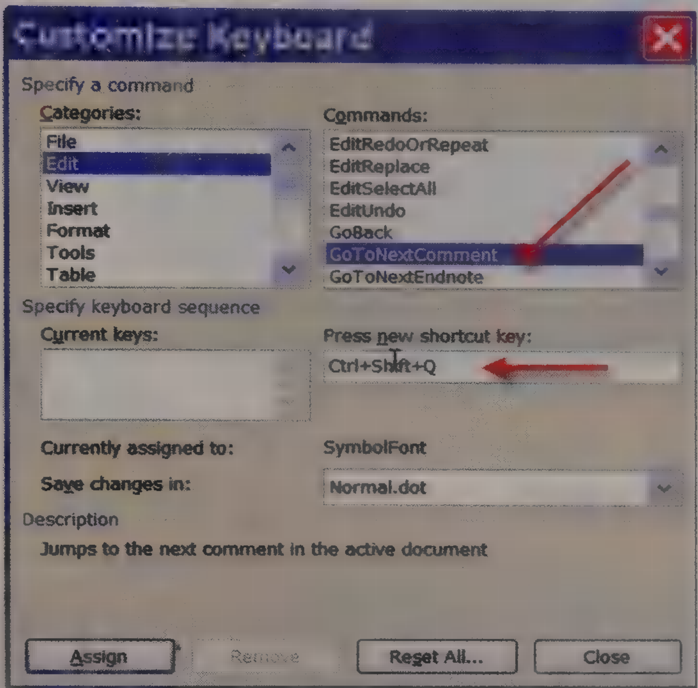
Here are the steps: Click on **Tools**, **Customize** and **Keyboard**, evoking this menu:



Then, select a category (under **Categories**) and an available command (under **Commands**) for which you want to create a keystroke shortcut (or the shortcut you would like to change if it already has one).

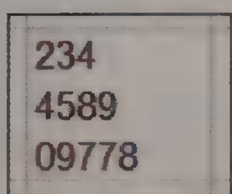
For example, if you want a shortcut to command Word to jump to the next comment in a document, find that action in the **Commands** list and highlight it. It also is more fully identified under **Description**. If the **Current keys** box is empty, that task has no assigned keys. You can assign keys to it by pressing the keys of your choice; they will appear under **Press new shortcut key**. Then click on **Assign** and **Close**.

If you're not happy with one of them, just change it.



ENTER SEVERAL SETS OF NUMBERS IN ONE EXCEL CELL

Q. Is there a way to put several sets of numbers—such as codes—into one Excel cell with each set on its own separate line?



A. You mean like this?

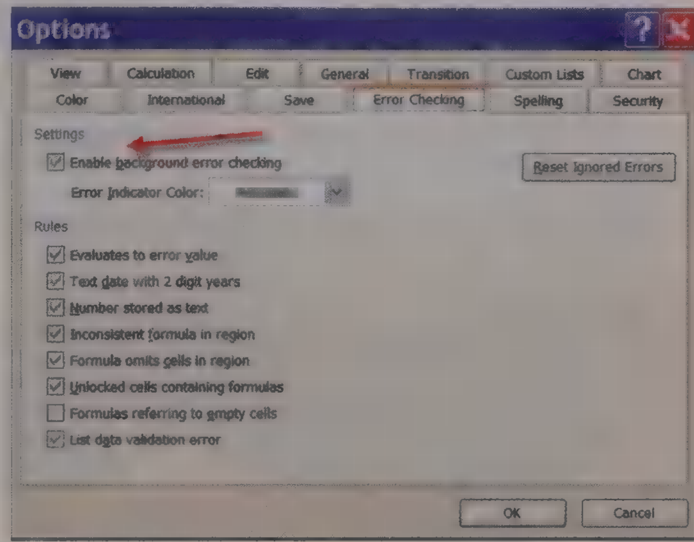
The trick is to press Alt+Enter each time you want the line in the cell to break.

OUT, OUT, GREEN TRIANGLES

Q. Some cells in my spreadsheets contain little green triangles in the upper left-hand corner (see screenshot at right), and I can't get rid of them, though sometimes—through no apparent effort on my part—they just disappear. Is my software infected with the dreaded green triangle virus?

A. No, it's not a virus. Those green triangles are Excel's way of telling you it believes the cells contain an error. Of course, sometimes Excel is wrong, but such error-flagging is a handy fail-safe function.

Why it happens: Excel 2002 and 2003 constantly work in the background scanning for possible errors. You can turn off the feature by clicking on **Tools**, **Options** and the **Error Checking** tab and unchecking the **Enable background error checking**. Then click on **OK**.



SHORTCUTS

- **Excel:** Press Ctrl+1 to engage the format menu in Excel.
- **Excel:** To quickly select a full table of contiguous cells, place your cursor anywhere in the cells and press Ctrl+Shift+8. To select a range of data, put the cursor in the first cell and press Ctrl+Shift+8. *Why it happens:* Excel defines a range of data as being a series of adjacent cells that contain data.
- **Windows:** To rename multiple files in Explorer in a single action, highlight all the files you wish to rename and right click on any one of them. Select **Rename** from the menu that appears and all the files will be given the same name as the one you selected with a number in brackets differentiating them. ■

STANLEY ZAROWIN, a former *JofA* senior editor, is now a contributing editor to the magazine. His e-mail address is zarowin@mindspring.com.

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to contributing editor Stanley Zarowin via e-mail at zarowin@mindspring.com or regular mail at the *Journal of Accountancy*, 201 Plaza Three, Harborside Financial Center, Jersey City, NJ 07311-3881.

Because of the volume of mail, we regret we cannot individually answer submitted questions. However, if a reader's question has broad interest, we will answer it in a Technology Q&A column.

On occasion you may find you cannot implement a function I describe in this column. More often than not it's because not all functions work in every operating system or application. I try to test everything in the 2000 and XP editions of Windows and Office. It's virtually impossible to test them in all editions and it's equally difficult to find out which editions are incompatible with a function. I apologize for the inconvenience.

No income deferral if services are involved.

Pay Now or Defer

BY LARRY MAPLES

Walk into your favorite grocery store and it's clear that some products get preferential treatment. One brand of soup may be at eye level, while others are on the bottom shelf, or a new product may be on prominent display at the end of an aisle. In many cases these product placements are not accidental; manufacturers may be paying the grocery chain for prime positions. Such payments are known as "slotting fees" and have become common in other business sectors such as computer software, books and magazines, tobacco products and automotive parts. "Slotting" is a generic term for a variety of fees paid by product manufacturers, including "display," "pay-to-stay," "failure" and "presentation" fees.

Retailers of all kinds receive money from manufacturers not only for slotting allowances, but also for purchase volume rebates and cooperative advertising allowances. The tax treatment of these promotion allowances has spawned a debate between retailers and the IRS. Some of the controversy arises from timing issues such as when payment is received and when claims are submitted, but IRS efforts to accelerate the taxation of these allowances usually is tied to its position that they are for services rendered by the retailer. In this article CPAs will learn when the IRS acceleration argument is vulnerable and how structuring advances as loans can result in deferral of income.

TRADE DISCOUNTS

In most cases discounts, allowances and rebates are tied to the volume that manufacturers and other vendors sell. Revenue ruling 84-41 defines trade discounts as a vendor's reduction of the purchase price depending on the quantity purchased. Regulations section 1.471-3(b) requires a trade discount to be treated as a reduction in purchase price of inventory rather than as an item of gross income. This treatment results in income deferral to the extent the discounted goods remain in inventory at year-end. This deferral-of-income opportunity prompted the IRS to take an aggressive stance on allowances that are paid up front or that are contingent on services performed by the retailer.

Retail Allowances Help

Profits fell 31% at Safeway and 6% at Albertsons in 2004. Without cash vendor allowances and slotting fees paid to grocery stores by food companies for prominent placement of their products, things would have been even worse. Such payments hit $100 billion in 2003.

Source: "Food Porn" by Seeth Labone, *Forbes*, p. 102, February 14, 2003.

ALLOWANCES FOR SERVICES

Retailers often obtain reimbursements of a portion of advertising costs from vendors under cooperative advertising

The IRS says cooperative advertising produces income when services are performed. Retailers say trade discounts are cost reductions.

plans, where they receive allowances based on their volume of business with a particular vendor. These agreements may stipulate the media to be used, the time of the ads and other conditions and require certain documentation. If the advertising allowance is volume-based, the vendor usually reduces the retailer's outstanding receivable or issues a credit for future purchases. Taxpayers have argued that those volume-based advertising allowances should be treated as reductions in the purchase price of the inventory per the trade discount rules discussed below.

The IRS, however, has viewed such allowances as reimbursements for resellers' services instead of reductions in inventory cost. In FSA 199915011 the IRS stated that income from cooperative advertising services should be accrued in the year the advertising is placed and stressed that the vendor is compensating the retailer for services rendered. The IRS disregards the fact the discounts are conditional on the retailer's purchases of merchandise. The economic reality is that the dominant factor in many of these agreements is the volume of purchases. The IRS position is based on looking at the form of the agreement that specifies advertising. But it should be noted that a retailer might choose to advertise whether or not a particular vendor's product is purchased.

Perhaps the best approach to solving this tax problem is to view these allowances from the retailer's business perspective. A trade publication, *Beverage World,* makes the following statement in a column dealing with whether retailers should consider private label soft drinks:

"Most major retailers participate in calendar marketing agreements or cooperative marketing agreements with their major soft drink suppliers. And, while it may appear that soft drink margins are slim to none when comparing retail pricing to invoiced cost, this is an outsider's interpretation of the business. Once ad allowances, display allowances, performance incentives and incremental incentives are put back into the profit picture, nationally branded soft drinks are tough for anyone to compete with from a profit perspective" (*Beverage World*, November 1992, page 75).

This comment should make it clear that a retailer's decision to obtain advertising or other allowances is primarily a margin-related decision. Margin-related costs arguably should be reflected in cost of goods sold. FSA 199915011 undoubtedly will not be the last word on the subject, particularly since the Emerging Issues Task Force took a position at odds with the IRS (see page 94).

CPAs should be aware that if the agreement provides for advertising, the IRS likely will not permit deferral even if it appears that volume is the real key to the agreement. But see the discussion on page 93 if the agreement is structured as a loan.

ADVANCE TRADE DISCOUNTS

A business that receives a volume discount as goods are purchased should have no problem accounting for the discount as a reduction in cost of the goods purchased under regulations section 1.471-3(b), unless the discount is partially for services rendered. If the discount is strictly volume-related, receiving it in advance is not a bar to deferring recognition until the goods are sold. However, an advance or lump-sum payment raises IRS suspicion that a payment for services has been made. Long ago the IRS succeeded in establishing the

EXECUTIVE SUMMARY

■ **THE DEFERRAL OF TRADE DISCOUNTS BY RETAILERS** has caused the IRS to closely police whether allowances contingent on services performed are really trade discounts. If a discount is strictly volume-related, receiving it in advance should not prevent deferral. But it may be very difficult to convince the IRS that an advance discount is not tied to services.

■ **MANY RETAILERS RECEIVE COOPERATIVE** advertising allowances that are volume-based. The IRS interprets these arrangements as vendor payments for advertising services rendered by the retailers.

■ **SLOTTING FEES PAID BY MANUFACTURERS** may be viewed as a way for retailers to negotiate the lowest inventory costs. But the IRS usually views them as a performance-related service that should be treated as income as shelf space is made available.

■ **PERFORMANCE-RELATED ALLOWANCES** may be deferred if they are structured as loans. IRS Publication 3106 outlines how payments received under an "image upgrade program" can be treated as a nontaxable loan. There appears to be no reason that other advances such as cooperative advertising could not also be structured as loans.

■ **THE EMERGING ISSUES TASK FORCE (EITF)** has established a presumption that cooperative advertising allowances are to be deferred in inventory unless it is clear they are payment for services. Since the IRS presumption is precisely the opposite, there is a conflict between these positions.

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precedent that an advance payment received for services may not be deferred (see *Schlude,* 372 US 128 (1963)).

For example, in TAM 9719005, the IRS ruled that lump-sum payments received in exchange for agreements to purchase a stated volume within a specified time were income when received. If the purchaser did not reach the stated volume within the time specified, the time period could be extended or the purchaser could be required to refund a pro rata portion of the cash received. The vendor also received the right to be the purchaser's exclusive or primary supplier of certain types of goods.

RESOURCES

- FASB, Emerging Issues Task Force, Issue no. 02-16.
- "How to Keep the SEC Happy," *Supermarket News*, December 13, 2004, page 28. Short article on the effects of Sarbanes-Oxley on trade promotion accounting practices.
- Internal Revenue Manual, *Vendor Rebates and Allowances.*
- IRS Publication 3106, *Overview of Imaging Reimbursement Program,* **www.irs.gov/pub/irspdf/p3106.pdf**.

The taxpayer took the position that the cash payments were trade discounts for goods to be purchased over a number of years. The IRS argued the payments were current income paid in exchange for the right to be an exclusive supplier. The IRS did not attempt to characterize the payments as either a trade discount or payment for a service. It took the position that the fact that the taxpayer had to do more than just purchase goods, and that the allowances were paid prior to the execution of the agreements, "undermine the notion that the payments are exclusively for trade discounts." Thus, the IRS approach seems to be that a trade discount mixed with other elements does not qualify as a trade discount for tax purposes.

Could a pure trade discount received in advance and based entirely on volume be deferred? Although this is not the fact pattern in TAM 9719005, the IRS hints at its answer by stating, "We have found no case in which a purported 'advance payment' for a trade discount was permitted to be deferred beyond the year of receipt."

CPAs should be aware that unless the facts establish clearly that no services are involved, the IRS will tax advances as they are received. CPAs recommending a deferral position should inform the client that a court test is likely unless the agreement is structured as a loan. (See discussion under the "Image Upgrade Programs as Loans" section at right.)

SLOTTING FEES

Some argue that charging suppliers slotting fees for prime placement of products is simply a way of negotiating a lower inventory cost. In this respect, it is instructive to note that big discounters such as Wal-Mart and Costco do not charge slotting fees, but rather demand rock-bottom wholesale prices and stock only the fastest-moving items. Thus, some view slotting fees as another angle on negotiating the lowest inventory cost. But others view slotting as simply renting space to manufacturers. The IRS agrees with the latter assessment and lumps slotting allowances, cooperative advertising and other discounts as "performance-related" vendor allowances. Performance-related allowances should not be deferred in inventory, but reported as income as services are rendered. CPAs pondering a deferral position therefore are unlikely to succeed unless the client is prepared for a court test. Again, the loan structure discussed next may be an alternative.

IMAGE UPGRADE PROGRAMS AS LOANS

The problem of including performance-related allowances in income may be overcome if the advances are structured as loans. In Publication 3106, *Overview of Imaging Reimbursement Program*, the IRS outlines the circumstances in which payments received under an "image upgrade program" can be treated as nontaxable loans. This brochure considered a hypothetical situation in which a petroleum company makes payments to enable a station owner to make certain improvements to upgrade the station's image. The station owner retains ownership of the improvements. His right to receive or retain the payments may be contingent on purchasing a specified volume of petroleum products and/or making the specified improvements. If the payments are bona fide loans, they will not be taxable whether received up front as a lump sum or as a series of payments. Expenditures made with the loan proceeds will be recovered as deductions immediately, or as depreciation or amortization if capitalization is appropriate.

The IRS looks for the following factors in determining whether a bona fide loan exists:

- A true debtor-creditor relationship between the payor and the recipient.
- An intent on the part of the recipient to repay the loans.
- An intent on the part of the payor (creditor) to enforce the obligation.
- A written loan agreement.
- Regular payment of interest and principal.
- A specific date for repayment.
- An unconditional obligation for repayment not contingent upon future events.

In a discussion I had with an IRS field agent, she related an audit situation in which the issue was whether image upgrade payments from a petroleum company were includable in income by a service station owner. The taxpayer, the owner of several retail petroleum LLCs, received an advance from the distributor, which the agent tested with the above criteria to determine whether it was income or a bona fide loan. The agreement was structured so that the advance would be repaid by a quantity discount on sales that exceeded certain monthly quotas. The agent found the agreement complied with the criteria, and therefore the advance was a loan and not income.

Although Publication 3106 deals specifically with an image upgrade program, there seems to be no reason CPAs

cannot suggest that advances for other purposes, such as cooperative advertising, also could be structured as loans. But IRS Publication 3106 is clear that merely labeling an agreement as a "loan" does not mean it will be treated as a loan for tax purposes. The agreement must meet the criteria discussed above. See the exhibit below for a summary of the IRS rationale in each of the areas discussed.

A DIFFERENT APPROACH

The Emerging Issues Task Force concluded that payments received by a reseller from a vendor for cooperative advertising are presumed to be product price reductions to be reflected as reductions in cost of goods sold as the products are sold (FASB, Emerging Issues Task Force, Issue no. 02-16). This presumption is overcome if the consideration is either a payment for assets or services or a reimbursement of costs the reseller incurred to sell the vendor's products. Payments for assets or services should be reported as income; cost reimbursements should be reported as reductions of that cost when it is recognized in the seller's income statement.

This EITF approach will change the period in which many reimbursements for cooperative advertising are recognized. For example, a company that previously had classified cooperative advertising reimbursements as reductions in advertising expense now should classify them as reductions in inventory costs, unless it is prepared to demonstrate that services have been rendered (or costs incurred) that would not have been reduced but for the "reimbursement." This would be difficult to demonstrate in the typical situation where cooperative advertising allowances are based on sales volume.

The EITF approach sets up a conflict between accounting rules and the IRS's treatment of cooperative advertising allowances. Income statement recognition now will occur generally in the period inventory is sold, whereas under the IRS approach the allowance will not be deferred in inventory. GAAP is normally considered to clearly reflect income (regulations sections 1.446-1(a)(2) and (c)(2)(ii)) unless the tax code or regulations specifically provide for an alternative method. The regulations are silent on cooperative advertising allowances, but the IRS continues to view them as producing income when advertising services are performed. The IRS view is open to criticism primarily because trade discounts attributable to cooperative advertising may have little relationship to actual advertising expenditures by the reseller. For example, a decision to increase advertising for a particular product may have no relationship to the advertising allowances available. And increasing a vendor's discount may not affect the reseller's total advertising budget.

The rationale behind the EITF approach may be very useful to CPAs who are considering taking the position that cooperative advertising or other promotion costs should be deferred.

PRACTICAL TIPS

- **When recommending a deferral position, inform the client that a court test is likely unless the agreement is structured as a loan.**
- **Although Publication 3106 deals specifically with an image upgrade program, consider structuring advances for other purposes, such as cooperative advertising, as loans.**
- **Before taking the position that cooperative advertising for other promotion costs should be deferred, carefully study the rationale in the EITF approach discussed in the article.**

STAY ON TOP OF IT ALL

CPAs should keep an eye on developments in this area. The unilateral IRS position that trade channel promotion costs should be taxed when received may be vulnerable and subject to revision. The lack of case law and the contrary position of the EITF are reasons to monitor developments. CPAs also may want to experiment with extending the loan structure rationale beyond image upgrades to the other costs discussed in this article. ■

Trade Promotion Income Issues

Trade promotion cost	Likely IRS treatment	Rationale
Trade discounts	Reduction in inventory costs	Tied to volume per Reg. section 1.471-3(b)
Advance trade discounts	Income upon receipt	If services performed, follow the *Schlude* line of cases. If no services, weak IRS argument based on lack of case law (see TAM 9719005)
Cooperative advertising	Income when advertising is placed	Form of agreements provide for advertising (see FSA 1999915011)
Slotting fees	Income as services are rendered	Performance-related vendor allowance (space rental) (see Internal Revenue Manual)
Image upgrades	Income as improvements are made unless structured as loan	Publication 3106 gives criteria for loan treatment

Tax Matters

TAX CASES

Conservation Easements

Do you have a client who's interested in protecting the environment as well as getting a tax break? Recently, the Tax Court considered the deductibility of a conservation easement to a charity.

In 1988 Mr. and Mrs. Charles Glass purchased property on the shore of Lake Michigan. In the 1990s bald eagles returned to this area, and one roosted on their land. The property also was a suitable habitat for a couple of endangered plants.

In 1990 the couple gave a conservation easement on part of the property to a qualified charity. In 1992 and 1993 they gave two additional easements to LTV, a Michigan nonprofit organization, for the purpose of ensuring the scenic and natural resource value of the property would be retained forever by preventing development of the listed parts of the property. The easements did not restrict development of other parts of the property, which the Glasses used as a vacation home until 1994, when they converted it to their principal residence. They claimed a charitable contribution for both easements. The IRS objected to the deduction.

Result. For the taxpayers. IRC section 170(f)(3) normally denies a charitable contribution for donations of less than a taxpayer's entire interest in a property, but there is an exception for a "qualified conservation contribution." To be eligible, the property must be a qualified real property interest, the contributee must be a qualified organization and the contribution must be exclusively for conservation purposes. The IRS said the contributions met the first two requirements but not the third.

Under section 170(h)(4) and (5), a contribution is made exclusively for conservation purposes if it is made in perpetuity and designed to

- Preserve land for the general public's outdoor recreation or education.
- Protect the relatively natural habitats of fish, wildlife or plants.
- Preserve open space for the public's scenic enjoyment.
- Preserve a historically important land area or structure.

The regulations expand the requirement to ensure the charity is able to enforce the restriction.

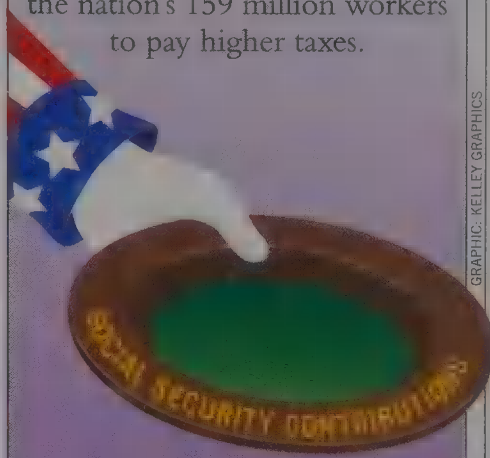
The legislative history makes clear that widespread use of this special contribution provision was not intended. The contribution should apply only to "the preservation of unique or otherwise significant land areas or structures." The taxpayers' case was aided by testimony from the director of the charity that the property was indeed a roosting spot for bald eagles and a proper place for threatened plants to grow. The Tax Court concluded the contribution met all the requirements.

Taxpayers desiring a charitable contribution for a conservation easement should carefully review the requirements, guarantee the documents contain the necessary provisions and restrictions and provide a qualified appraisal for the amount of the deduction.

■ *Charles F. Glass* v. *Commissioner*, 124 TC no. 16.

More Please

The increase in the wage base (to $90,000 from $87,900 in 2004) subject to Social Security taxes will cause 9.9 million of the nation's 159 million workers to pay higher taxes.



Source: Social Security Administration, www.ssa.gov.

Prepared by Edward J. Schnee, CPA, PhD, *Hugh Culverhouse Professor of Accounting and director, MTA program, Culverhouse School of Accountancy, University of Alabama, Tuscaloosa.*

What Makes It Alimony?

When do family support payments constitute alimony? CPAs advising clients about their tax status in a divorce need to know the rules.

Alimony payments are deductible for tax purposes for a payor spouse but represent gross income to the payee. Under a divorce or separation agreement, payments are considered alimony if they are made in cash to an ex-spouse not living in the same household as the payor and not designated as either child support or a property settlement. Also the payor can't be liable to make payments after the death of the spouse (a continuing payment liability) or in place of postdeath payments (substitute payment liability).

Michael Berry was divorced from his wife in 1997. The divorce judgment required him to pay approximately $4,000 a month in support to his ex-wife and their two minor children. Under California law, a family support agreement combines spousal and child support without stating the specific amount of each component. Berry deducted the family support payments as alimony on his 1999 tax return; however that deduction was disallowed by the IRS. The taxpayer petitioned the Tax Court for relief. *(continued on page 97)*


CHOOSING THE RIGHT PARTNER IS EVERYTHING.

Result. For the taxpayer. Family support payments would not be deductible as alimony if they created either a continuing payment liability or a substitute payment liability. The court first determined whether Berry had any obligation to make those payments after the death of his ex-wife. Since the divorce agreement did not address the issue, the court examined California and related case law. Neither dealt directly with the issue. In the court's judgment Berry would not have had to continue making those payments to her estate since it was unlikely a state court would recognize her estate as having an enforceable interest in the payments. Thus there was no continuing payment liability.

The court then examined whether Berry had an obligation to make payments in lieu of the child support component after his ex-wife's death. The IRS argued that all parents are required to support their children until the age of emancipation; therefore the taxpayer would be required to make child support payments if his ex-wife died, thus creating a substitute payment liability. This argument is based on a "worst case scenario approach" previously advanced by the Tax Court in which it is assumed that a third party is awarded custody of the minor children after the death of an ex-spouse and state law requires the taxpayer to make child support payments to that third party (*Wells* v. *Commissioner*, TC Memo (1998-2)). Under that theory, family support payments represent substitute payments since they include an undesignated child support component for which the taxpayer's obligation continues after the death of his ex-wife.

The court rejected this argument stating that it implied the only amount required to be designated as child support in a divorce agreement is an amount in excess of that required under state law, since state law automatically would cause part of unallocated support payments to be considered child support. The court further stated it clearly was not the intent of Congress to have state law determine what portion of unallocated support payments represented child support when the divorce agreement did not. In addition, if state law automatically fixes a portion of unallocated payments as child support, IRC section 71(c)(1)—which disqualifies as alimony any amount specifically designated as child support in the divorce agreement—would not be necessary.

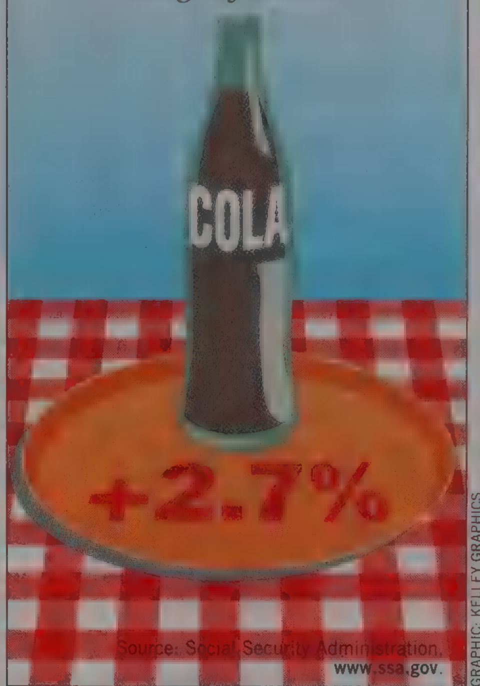
This case resolves the issue of whether parents' general obligation to support their minor children after the death of an ex-spouse automatically causes the creation of a substitute payment liability when undesignated family support payments are present, and rejects the application of the "worst case scenario approach" to that situation.

■ *Michael K. Berry* v. *Commissioner*, TC Memo, 2005-91.

Prepared by Charles J. Reichert, CPA, *professor of accounting, University of Wisconsin, Superior.*

Good News From the SSA

More than 47 million Social Security recipients benefited from this year's 2.7% cost-of-living adjustment.



Rate Changes Bring Record Drop

There were 160 sales and use tax rate decreases for tax year 2004, the highest amount since 1996.

No Marketability Discount for Lottery Winnings

The Massachusetts District Court held in *Estate of Donovan* v. *United States* that, for estate tax purposes, the value of a stream of lottery payments due to a decedent must be based on the annuity valuation tables in IRC section 7520 without a discount for lack of marketability.

The decedent, John R. Donovan, won the Massachusetts lottery in January 1999. He received the first of 20 annual payments of $100,000 on the day he won, but died in July. Under Massachusetts law the decedent was prohibited from assigning the lottery payments. Based on this restriction, an appraiser determined the value of the 19 remaining payments was $367,482. The estate used that amount on its return; however, the IRS determined, based on the annuity valuation tables, that the value of the remaining payments was $1,091,553.

The decedent's estate paid the resulting deficiency and subsequently sought a refund in the Massachusetts District Court. The IRS and the estate executor agreed the lottery payments should be included in the decedent's gross estate but disagreed as to their valuation. The first issue was whether the lottery payments constituted an annuity. The second was whether the section 7520 annuity valuation tables should be applied or a discount for lack of marketability allowed. *(continued on page 98)*

Result. For the IRS. The district court held the payments were an annuity and should be valued in accordance with the section 7520 tables. The provisions of that section define an annuity as "the right to receive a fixed dollar amount at the end of each year during one or more measuring lives or for some other defined period."

The estate argued that, due to the restrictions on assignment of the lottery winnings, the "restricted beneficial interest" exception applied. The exception provides that valuation according to annuity tables is not required where an interest is restricted by a contingency, power or other limitations. However, the court noted the exception applies to restrictions that limit the decedent's *receipt* of payments, not to restrictions that affect his ability to *dispose* of payments. Accordingly, the exception did not apply and the lottery winnings were held to be an annuity.

The court next turned to valuation of the lottery annuity. Generally, the section 7520 tables must be used to value annuities unless their use would have an unreasonable result. The district court noted a split among the few circuit courts that have ruled in such cases. The Second Circuit Court of Appeals and the Ninth Circuit have held that the right to transfer property is a fundamental right of ownership and that any restriction on that right affects the value of the property. Therefore, those circuit courts have upheld a marketability discount for lottery payments. The Fifth Circuit, however, has held that such discounts are improper because there is an underlying assumption of nonmarketability in the annuity tables.

The decedent's estate had sought valuation of the lottery annuity based on the willing buyer/willing seller standard, whereby what a willing buyer would pay for property is attributed to the willing seller. Since the estate tax values assets in the hands of the decedent, not a third party, it is inappropriate to use this method of valuation.

What was at issue in this case was essentially an income interest unaffected by market forces. The fact that the interest could not be assigned did not affect its value for estate tax purposes. Accordingly, for the time being CPAs should use the section 7520 annuity tables to value a client's right to an annual stream of lottery winnings. However, *Donovan* has been appealed to the First Circuit, which has not yet ruled on the case. Given the split that already exists, it is possible this issue ultimately may be heard by the U.S. Supreme Court.

■ *Estate of John R. Donovan, Jr.* v. *United States,* 2005 US Dist., Lexis 7232; 95 AFTR2d 2005-2131 (April 26, 2005).

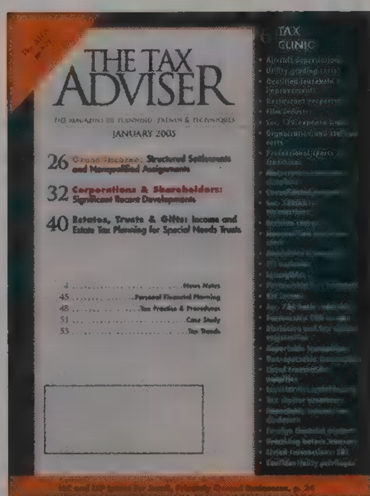
Prepared by Laura Lee Mannino, CPA, LLM, *assistant professor of accounting and taxation, St. John's University, New York.* ■

Special education as a medical expense.

From The Tax Adviser:

Dyslexia Program Tuition Is a Valid Deduction

In letter ruling 200521003, the IRS held that tuition paid to a school program to help dyslexic children deal with their condition was an IRC section 213(a) deductible medical expense. The ruling broadens—albeit slightly—the definition of the kinds of payments that qualify as deductible medical costs. CPAs, however, should be aware of the ruling's inherent limits and be prepared to address the other restrictions on the medical deduction.



OVERVIEW

In the ruling, the taxpayers' two children were diagnosed with disabilities caused by medical conditions (including dyslexia) that handicapped their ability to learn. The taxpayers enrolled the children in a school that provided them with special education designed to enable them to cope.

HOLDING AND ANALYSIS

The IRS first explained that "normal education" is not medical care, because it is not designed to overcome a medical disability. For education to be considered medical care, a physician or other qualified professional must diagnose a medical condition that requires special education to correct it. Although a school need not hire doctors, it must have professional staff competent to design and supervise a curriculum providing such care. Overcoming the disability must be a primary reason for the child's attending the school; any ordinary education received must be incidental to that.

The IRS ruled that the children were attending the school principally to receive medical care in the form of special education in the years they were diagnosed as having a medical condition that hindered their ability to learn. Thus, the taxpayers can deduct tuition as a section 213(a) medical expense for the years the children continue to be diagnosed as medically handicapped. Citing revenue ruling 69-607, the IRS further held that dyslexia could be sufficiently severe as to be such a handicap.

This ruling expands the types of tuition payments that may be deductible as medical expenses. It refutes the presumption that educational institutions must be "special schools" for their tuition to be deductible. It confirms that tuition for programs designed to enable dependents to deal with a diagnosed medical handicap—such as dyslexia—qualifies as a medical deduction, as long as other requirements are met.

LIMITS

Before taxpayers claim tuition as a deduction, however, there are other requirements in letter ruling 200521003:

- Medical care must be a principal purpose for attending the institution.
- The institution's program must be designed and administered by qualified professionals for the purposes of treating the dependent's medical condition.
- Ordinary education must be incidental.

Further, medical expenses are deductible only to the extent they exceed 7.5% of the taxpayer's adjusted gross income. Finally, letter rulings apply only to the taxpayer who obtained the ruling; they are not precedential. However, they do show the service's thinking on a particular issue.

For more information, see the Tax Clinic, edited by Joel Ackerman, in the October 2005 issue of *The Tax Adviser.*

—Lesli S. Laffie, editor
The Tax Adviser

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AICPA Financial Literacy Campaign Praised

The Institute's 360 Degrees of Financial Literacy campaign (**www.360financialliteracy.org**) was cited for excellence—for the third and fourth times since its inception in May 2004.

For an unprecedented second consecutive year, the program received the 2005 Summit Award from the American Society of Association Executives (ASAE). The ASAE's Associations Advance America Awards honor innovative projects in public education and other fields. The campaign also won the Association for Women in Communications' 2005 Clarion Award in the public affairs campaign category. This citation recognizes superior advertising and marketing, publications, collateral materials, public relations and multimedia programs.

Carl George, chair of the AICPA National CPA Financial Literacy Commission and CEO of Clifton Gunderson LLP, said, "The recognition our program has received tells us that the CPA profession was right in identifying the need for financial literacy education in this country. These awards also are a tribute to the state CPA societies and the many thousands of CPAs who have devoted their time, energy and creativity to improving the level of financial literacy in America."

Earlier the 360 Degrees of Financial Literacy program had earned a Crystal Award and a Web Star Award (**www.aicpa.org/pubs/jofa/aug2005/inside.htm**). ■

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Exposure Drafts Outstanding

(This list was compiled as of October 1, 2005. For exposure drafts issued after that date, consult *The CPA Letter*. *Note:* The policy for updating the list of exposure drafts is that a document should remain on the list until a final document has been issued or the project has been dropped. However, no comments will be received after the comments deadline has expired. The list is not all-inclusive but is intended to present the exposure drafts of particular interest to professional accountants.)

Issue Date	Title or Description	Comment Deadline
FASB		
9/30/05	**Selected Issues Relating to Assets and Liabilities with Uncertainties**	**1/3/06**
9/30/05	**Earnings per Share—an amendment of FASB Statement No. 128 (revision of Exposure Draft issued 12/15/03)**	**11/30/05**
8/11/05	**Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140**	**10/10/05**
8/11/05	**Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140**	**10/10/05**
8/11/05	**Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140**	**10/10/05**
7/14/05	Accounting for Uncertain Tax Positions—an interpretation of FASB Statement No. 109	9/12/05
6/30/05	Business Combinations—a replacement of FASB Statement No. 141	10/28/05
6/30/05	Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries—a replacement of ARB No. 51	10/28/05
4/28/05	The Hierarchy of Generally Accepted Accounting Principles	6/27/05
6/23/04	Fair Value Measurements	9/7/04
AcSEC (AICPA)		
11/29/04	Proposed Statement of Position, Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements	1/7/05
6/19/03	Proposed Statement of Position, Allowance for Credit Losses	9/19/03
12/17/02	Proposed Statement of Position, Clarification of the Scope of the Audit and Accounting Guide Audits of Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investment in Investment Companies	3/31/03
ASB (AICPA)		
9/1/05	**Proposed Statement on Auditing Standards: *Communication of Internal Control Related Matters Noted in an Audit***	**10/31/05**
6/15/05	Proposed Statement on Auditing Standards: Amendment to "Due Professional Care in the Performance of Work" of Statement on Auditing Standards No. 1, *Codification of Auditing Standards and Procedures*; Amendment to Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*; Audit Evidence; Audit Risk and Materiality in Conducting an Audit; Planning and Supervision; Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement; Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained; *and* Amendment to Statement on Auditing Standards No. 39, *Audit Sampling*	8/15/05
5/9/05	Proposed Statement on Auditing Standards: Amendment to Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity with Generally Accepted Accounting Principles, for Nongovernmental Entities	6/27/05
3/2/05	Proposed Statement on Auditing Standards: Defining Professional Requirements in Statements on Auditing Standards and Proposed Statement on Standards for Attestation Engagements: Defining Professional Requirements in Statements on Standards for Attestation Engagements	5/15/05
1/12/05	Proposed Statement on Auditing Standards: Audit Documentation	5/15/05
3/18/03	Proposed Statements on Auditing Standards and Statement on Standards for Attestation Engagements Related to Internal Control: Auditing an Entity's Internal Control Over Financial Reporting in Conjunction With the Financial Statement Audit; Amendment to Statement on Auditing Standards No. 100, Interim Financial Information; and Reporting on an Entity's Internal Control over Financial Reporting*	5/15/03
OTHER (AICPA)		
9/15/05	**Proposal of Professional Ethics Division: Proposed Revision to "Other Considerations" in Interpretation 101-1, *Interpretation of Rule 101*, under Rule 101, and Proposed Conceptual Framework for AICPA Independence Standards**	**12/16/05**
9/15/05	**Omnibus Proposal of Professional Ethics Division Interpretations and Rulings**	**12/16/05**
3/30/05	Proposed Statement on Standards for Valuation Services: Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset	9/30/05
9/20/04	XBRL US Financial Reporting Taxonomy Framework	11/19/04
11/15/02	Proposed Tax Standards Interpretation 1-2, "Tax Planning," of Statement on Standards for Tax Services No. 1, *Tax Return Positions*	4/30/03
11/1/01	AICPA/NASBA Uniform Accountancy Act and Uniform Accountancy Act Rules	12/31/01
3/7/01	Statement on Standards for Continuing Professional Education Programs	8/1/01
SEC		
4/15/04	Use of Form S-8 and Form 8-K by Shell Companies; Release No. 34-49566	6/7/04
3/11/04	First-Time Application of International Financial Reporting Standards; Release Nos.: 33-8397; 34-49403; International Series Release No. 1274 (See Correction 3/18/04; Release Nos. 33-8397A; 34-49403A; International Series Release No. 1274A)	4/19/04
6/26/02	Framework for Enhancing the Quality of Financial Information Through Improvement of Oversight of the Auditing Process; Release Nos. 33-8109; 34-46120; 35-27543; IA-2039; IC-25624	9/3/02

*New additions appear in **bold** type.*

*This exposure draft has been submitted to the Public Company Accounting Oversight Board for its consideration as auditing and attestation standards.

EXPOSURE DRAFTS OUTSTANDING

Issue Date	Title or Description	Comment Deadline
5/10/02	Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies (Release Nos. 33-8098; 34-45907)	7/19/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 33-8090	6/24/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 34-45742	6/24/02
2/18/00	SEC Concept Release: International Accounting Standards	5/23/00
1/21/00	Supplementary Financial Information	4/17/00

[redacted]

Issue Date	Title or Description	Comment Deadline
9/30/05	**Sales and Pledges of Receivables and Future Revenues**	**12/30/05**
3/25/05	Accounting and Financial Reporting for Pollution Remediation Obligations (preliminary views)	6/24/05

[redacted]

Issue Date	Title or Description	Comment Deadline
9/23/05	**Improvements to International Public Sector Accounting Standards**	**1/31/06**
9/23/05	**Equal Authority of Paragraphs in IPSASs**	**1/31/06**
4/15/05	Proposed International Education Standard for Professional Accountants, "Competence Requirements for Audit Professionals"	7/15/05
3/22/05	Proposed International Standard on Auditing 600 (Revised), "The Audit of Group Financial Statements"	7/31/05
3/22/05	Proposed ISA 260 (Revised), "The Auditor's Communication with Those Charged with Governance"	7/31/05
3/22/05	Proposed ISA 705 and ISA 706, "Modifications to the Opinion in the Independent Auditor's Report and Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report"	7/31/05
2/4/05	Proposed International Public Sector Accounting Standard, "Financial Reporting Under the Cash Basis of Accounting—Disclosure Requirements for Recipients of External Assistance"	6/15/05
12/20/04	Proposed ISA 320 (Revised), "Materiality in the Identification and Evaluation of Misstatements"	4/30/05
12/20/04	Proposed ISA 540 (Revised), "Auditing Accounting Estimates and Related Disclosures (Other than Those Involving Fair Value Measurements and Disclosures)"	4/30/05
11/9/04	International Guidelines on Environmental Management Accounting (EMA)	2/28/05
10/5/04	Proposed Revised Code of Ethics for Professional Accountants	11/30/04
9/23/04	Policy Statement, "Clarifying Professional Requirements in International Standards" and Consultation Paper, "Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements"	12/31/04
9/23/04	ISA 230 (Revised), "Audit Documentation" and amendments to ISA 330, "The Auditor's Procedures in Response to Assessed Risks" and ISQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial and Other Assurance and Related Services Engagements"	1/31/05
7/14/04	Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services—IAASB Due Process and Working Procedures	10/15/04
1/20/04	Revenue from Non-Exchange Transactions (Including Taxes and Transfers)	6/30/04
1/20/04	Accounting for Social Policies of Governments	6/30/04
12/23/03	ISA 600 (Revised), "The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements" and IAPS, "The Audit of Group Financial Statements"	3/31/04
12/22/03	ISA700 (Revised), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" Amendment to ISA 210, "Terms of Audit Engagements" Conforming Amendments	3/31/04
11/11/03	Revision to Code of Ethics for Professional Accountants	2/15/04
7/18/03	Proposed Revised Code of Ethics for Professional Accountants	11/30/03
6/24/03	Proposed International Standard on Auditing: "Review of Interim Financial Information Performed by the Auditor of the Entity"	9/30/03

*New additions appear in **bold** type.*

[redacted]

Issue Date	Title or Description	Comment Deadline
7/22/05	Technical Agenda Options	9/9/05
6/27/05	Accounting for Fiduciary Activities (Revised)	8/30/05

[redacted]

At the present time PCAOB exposure drafts have very short comment periods. A list of outstanding PCAOB exposure drafts is available online at **www.pcaobus.org**.

INFORMATION

The initials stand for the following organizations. Exposure drafts are available online at the Web addresses below or copies may be obtained at the address in parentheses (unless otherwise indicated).

FASB— Financial Accounting Standards Board (Order Department, Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); also available online at **www.fasb.org**

GASB— Governmental Accounting Standards Board (Order Department, Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); also available online at **www.gasb.org**

AICPA— American Institute of CPAs (American Institute of Certified Public Accountants, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881). AICPA publishes exposure drafts exclusively on the Web site at **www.aicpa.org**. Print copies are not available.

IASB— International Accounting Standards Board (International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom), also available online at **www.iasb.org.uk**

IFAC— International Federation of Accountants (International Federation of Accountants, 545 Fifth Avenue, 14th Floor, New York, NY 10017); also available online at **www.ifac.org**

SEC— Securities and Exchange Commission (Securities and Exchange Commission, 450 5th Street, N.W., Washington, DC 20549); also available online at **www.sec.gov**

FASAB— Federal Accounting Standards Advisory Board (Federal Accounting Standards Advisory Board, 441 G Street, N.W., Suite 6814, Washington, DC 20548); also available online at **www.fasab.gov**

GAO— U.S. Government Accountability Office (Government Auditing Standards Comments, Marcia B. Buchanan, U.S. General Accounting Office, Room 5089, 441 G Street, N.W., Washington, DC 20548); **www.gao.gov**

PCAOB— Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, DC 20006-2803; info@pcaobus.org

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Official Releases

FASAB 29…FASAB 30…SSARS 12…SSARS 13…SSARS 14…
SSARS Interpretation…Auditing Interpretations

*Space considerations prevent publishing here the appendices to FASAB Statement nos. 29 and 30. Since the appendices often are important to understanding FASAB statements, readers are advised to refer to the complete document. The full text of Statement nos. 29 and 30 can be found online at **www.fasab.gov/standards.html**.*

Statement of Federal Financial Accounting Standards No. 29—Heritage Assets and Stewardship Land

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

SUMMARY

This standard changes the classification of information reported for heritage assets and stewardship land provided by Statement of Federal Financial Accounting Standards 8. This standard reclassifies all heritage assets and stewardship land information as basic except for condition information, which is reclassified as required supplementary information (RSI). This standard requires that entities reference a note on the balance sheet that discloses information about heritage assets and stewardship land, but no asset dollar amount should be shown. Instead, the note disclosure provides minimum reporting requirements consistent with the previous standards for heritage assets and stewardship land. These requirements include a description of major categories, physical unit information for the end of the reporting period, physical units added and withdrawn during the year, a description of the methods of acquisition and withdrawal, and condition information.

This standard also requires two new disclosures for heritage assets and stewardship land. Specifically, this standard requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.

This standard also includes the requirements for the U.S. Government-wide Financial Statement. It provides for a general discussion and directs users to the applicable entities' financial statements for more detailed information on heritage assets and stewardship land.

This standard amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serve as a means to incorporate all standards specific to heritage assets and stewardship land into one document.

TABLE OF CONTENTS

INTRODUCTION

1. The required supplementary stewardship information (RSSI) category, as described in Statement of Federal Financial Accounting Standards (SFFAS) 8, was a response to the unique aspects of the Federal accounting and reporting environment, and to the broad objectives of Federal financial reporting. It was intended to permit flexibility on the part of preparers and auditors that would facilitate reporting relevant, reliable information, including nonfinancial and nonhistorical information.[1]

2. Although some stewardship information may not link directly with the basic financial statements because the data to be reported may be other than in dollar terms, the Federal Accounting Standards Advisory Board (the Board or FASAB) intended that RSSI information would augment the basic financial statements and would receive commensurate audit scrutiny.

3. The Board found, however, that in many cases the word "supplementary" in the RSSI title caused certain readers to assume that the information was of secondary importance. Since this was contrary to its intentions, the Board decided to eliminate the RSSI category and recategorize the stewardship elements within the reporting categories that are well defined in existing professional literature and familiar to report users. Additionally, this standard clarifies the Board's expectation that information essential to fair presentation will be subject to audit.

4. The main focus of this standard is the reclassification of heritage assets and stewardship land information. This standard reclassifies heritage assets and stewardship land information as basic information with the exception of condition reporting, which is considered RSI[2]. Specifically, this standard requires that entities reference a note on the balance sheet that discloses information about heritage assets and stewardship land, but no asset dollar amount should be shown. The note disclosure provides minimum reporting requirements consistent with the previous standards for heritage assets and stewardship land, which includes a description of major categories, physical unit information for the end of the reporting period, physical units added and

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[1] See the *Implementation Guide to Statement of Federal Financial Accounting Standards 7: Accounting for Revenue and Other Financing Sources*, par. 22-24, the diagram on page 15, and minutes of associated Board discussions. See also SFFAS 8, *Supplementary Stewardship Reporting*, par. 21, 34, 111-115, and minutes of associated Board discussions.

[2] RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, published by the Financial Accounting Standards Board (FASB) in 1979. That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, Governmental Accounting Standards Board (GASB), and FASAB. The auditor's responsibility for RSI is discussed in section AU 558 of the codification of professional auditing standards published by the American Institute of Certified Public Accountants (AICPA).

withdrawn during the year, a description of the methods of acquisition and withdrawal, and condition information.

5. Although the most significant change within this standard is this reclassification, it also introduces certain changes to the disclosure requirements for heritage assets and stewardship land. Specifically, the standard requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.

6. This standard also includes disclosure requirements applicable to the U.S. Government-wide Financial Statement. This financial statement must provide a general discussion of heritage assets and stewardship land and direct users to the applicable entities' financial statements for more detailed information on these assets.

7. This standard also amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serve as a means to incorporate all standards specific to heritage assets and stewardship land into one document.

8. The Board believes by fully incorporating into this standard all requirements for heritage assets (including multi-use heritage assets) and stewardship land, readers will better understand all reporting requirements. However, the main issues deliberated by the Board were the reclassification and presentation of heritage assets and stewardship land information. The Board has not reconsidered the definition, recognition and measurement provisions of the existing standards. These provisions have been brought forward from those standards that were based on prior Boards' conclusions.

9. The Board developed this standard for heritage assets and stewardship land based on the importance of the data in meeting the stewardship reporting objective as described in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*. Further information on the Board's considerations regarding this reclassification is included in the Basis for Conclusions.

STANDARDS OF FEDERAL FINANCIAL ACCOUNTING

Heritage Assets (including Multi-use Heritage Assets)

Amendments to Existing Standards

10. SFFAS 6 par. 21 is amended as follows: The following paragraphs provide recognition and measurement principles, and disclosure requirements for general PP&E. For standards relating to heritage assets, multi-use heritage-assets and stewardship land, see SFFAS 29, *Heritage Assets and Stewardship Land*. ~~each category of PP&E. The categories identified are:~~
- ~~general PP&E (including land acquired for or in connection with other general PP&E),~~
- ~~National Defense PP&E,~~
- ~~heritage assets, and~~
- ~~stewardship land (i.e., land not included in general PP&E).~~

11. SFFAS 6 par. 57 through 65 are rescinded.

12. SFFAS 8 Chapter 2 (Heritage Assets) is rescinded in its entirety.

13. SFFAS 14 par. 10 and 11 are rescinded.

14. SFFAS 16 is rescinded in its entirety.

Definitions

15. Heritage assets are property, plant and equipment (PP&E) that are unique for one or more of the following reasons:
- historical or natural significance,
- cultural, educational, or artistic (e.g., aesthetic) importance; or
- significant architectural characteristics.

Heritage assets consist of (1) collection type heritage assets, such as objects gathered and maintained for exhibition, for example, museum collections, art collections, and library collections; and (2) non-collection-type heritage assets, such as parks, memorials, monuments, and buildings.

16. Heritage assets are generally expected to be preserved indefinitely. One example of evidence that a particular asset is heritage in nature is that it is listed on the National Register of Historic Places.

17. Some investments in heritage assets (e.g., national parks) will meet the definitions and be considered and reported as both heritage assets and stewardship land (see Stewardship Land below). Such reporting would not be considered duplication, as the type of information reported for the physical unit would be different for each category of stewardship asset.

18. Heritage assets may in some cases be used to serve two purposes—a heritage function and general government operations. In cases where a heritage asset serves two purposes, the heritage asset should be considered a **multi-use heritage** asset if the predominant use of the asset is in general government operations (e.g., the main Treasury building used as an office building). Heritage assets having an incidental use in government operations are not multi-use heritage assets; they are simply heritage assets.

Recognition and Measurement

Heritage Assets

19. With the exception of multi-use heritage assets (addressed in par. 22) the cost of acquisition, improvement, reconstruction, or renovation of heritage assets should be recognized on the statement of net cost for the period in which the cost is incurred. The cost[3] should include all costs incurred during the period to bring the item to its current condition (See par. 26 of SFFAS 6 for examples of the costs to be considered).

20. With the exception of multi-use heritage assets (addressed in par.23) no amounts for heritage assets acquired through donation or devise[4] should be recognized in the cost of heritage assets.[5]

21. With the exception of multi-use heritage assets (addressed in par. 24) transfers of heritage assets from one Federal entity to another do not affect the net cost of operations or net position of either entity. However, in some cases, assets included in general PP&E may be transferred to an entity for use as heritage assets. In this instance, the transferring entity should recognize a transfer-out of capitalized assets.[6]

Multi-use Heritage Assets

22. The cost of acquisition, improvement, reconstruction, or renovation of multi-use heritage assets should be capitalized as general PP&E and depreciated over its estimated useful life.

23. Multi-use heritage assets acquired through donation or devise should be recognized as general PP&E at the assets' fair value at the time received, and the amount should also be recognized as "nonexchange revenues" as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources*.

24. Transfers of multi-use heritage assets from one Federal entity to another are transfers of capitalized assets. The receiving entity should recognize a transfer-in as an additional financing source and the transferring entity should recognize a transfer-out. The value recorded should be the transferring entity's book value of the multi-use heritage asset. If the receiving entity is not provided the book value, the multi-use heritage asset should be recorded at its estimated fair value.[7]

Disclosures and Required Supplementary Information

25. Entities with heritage assets should reference a note[8] on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown.[9] The note disclosure related to heritage assets should provide the following:

a. A concise statement explaining how they relate to the mission of the entity.

b. A brief description of the entity's stewardship policies for heritage assets. Stewardship policies for heritage assets are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of heritage assets consistent with statutory requirements, prohibitions, and limitations governing the entity and the heritage assets.

c. A concise description of each major category of heritage asset. The appropriate level of categorization of heritage assets should be meaningful and determined by the preparer based on the entity's mission, types of heritage assets, and how it manages the assets.

d. Heritage assets should be quantified in terms of physical units. The appropriate level of ag-

[3] For a full discussion of cost, including full cost, direct cost and indirect cost, see SFFAS 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. Also, see par. 94–95, SFFAC 2, *Entity and Display*.

[4] A will or clause of a will disposing of property.

[5] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 258–259 explains that stewardship PP&E is "expensed if purchased, but no amount is recognized if it is received as a donation."

[6] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 and par. 345-346.

[7] See SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 for a discussion of transfers of assets.

[8] This standard does not prescribe a specific reference or line item entitled "Heritage Assets" as it may be included with other items for which no dollar amounts are recognized (such as stewardship land and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.

[9] No asset dollar amount is shown, except for multi-use heritage assets, which are capitalized and reported as part of general PP&E. See par. 22 through 24 and par. 27 for additional explanation.

gregation and physical units[10] of measure for each major category should be meaningful and determined by the preparer based on the entity's mission, types of heritage assets, and how it manages the assets. For each major category of heritage asset (identified in c. above) the following should be reported:

1. The number of physical units by major category; major categories should be classified by collection or non-collection type heritage assets for which the entity is the steward as of the end of the reporting period;

2. The number of physical units by major category that were acquired and the number of physical units by major category that were withdrawn during the reporting period; and

3. A description of the major methods of acquisition and withdrawal of heritage assets during the reporting period. This should include disclosure of the number of physical units (by major category) of transfers of heritage assets between Federal entities and the number of physical units (by major category) of heritage assets acquired through donation or devise, if material. In addition, the fair value of heritage assets acquired through donation or devise during the reporting period should be disclosed, if known and material.

26. Entities should report the condition[11] of the heritage assets (which may be reported with the deferred maintenance information[12]) as required supplementary information. Entities should include a reference to the condition and deferred maintenance information[13] if reported elsewhere in the report containing the basic financial statements.

27. Entities should disclose that multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements and that additional information for the multi-use heritage assets is included with the heritage assets information.

U.S. Government-wide Financial Statement Disclosures[14]

28. The U.S. Government-wide financial statement should reference a note on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown. The note disclosure related to heritage assets should provide the following:

a. A concise statement explaining how they relate to the mission of the Federal Government.

b. A description of the broad categories of heritage assets of the Federal Government.

c. A general reference to agency reports for additional information about heritage assets, such as agency stewardship policies for heritage assets, physical units by major categories of heritage assets, and the condition of the heritage assets.

29. The U.S. Government-wide financial statement should disclose that multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements and that additional information for the multi-use heritage assets is included with the heritage assets information.

Stewardship Land

Amendments to Existing Standards

30. SFFAS 6 par. 66 through 76 are rescinded.

31. SFFAS 8 Chapter 4 (Stewardship Land) is rescinded in its entirety.

32. SFFAS 14 par. 10 and 11 are rescinded.

Definitions

33. Stewardship Land is land and land rights[15] owned by the Federal Government but not acquired for or in connection with[16] items of general PP&E. Examples of stewardship land include land used as forests and parks, and land used for wildlife and grazing.

34. "Land" is defined as the solid part of the surface of the earth. Excluded from the definition are the natural resources (that is, depletable resources, such as mineral deposits and petroleum; renewable resources, such as timber; and the outer-continental shelf resources) related to land.[17]

35. Land and land rights owned by the Federal Government and acquired for or in connection with items of general PP&E should be accounted for and reported as general PP&E.

36. Land and land rights owned by the Federal Government and not acquired for or in connection with items of general PP&E should be reported as stewardship land.

Recognition and Measurement

37. The cost of acquisition of stewardship land should be recognized on the statement of net cost for the period in which the cost is incurred. The cost should include all costs to prepare stewardship land for its intended use (e.g., razing a building). In some cases, land may be acquired along with existing structures. The following treatments should apply:

a. if the structure would be deemed a heritage asset and is significant in and of itself, the entity should use its judgment as to whether the acquisition cost should be treated as the cost of stewardship land, heritage asset, or both;

b. if the structure is to be used in operations (for example, as general PP&E) but 1) the value of the structure is insignificant, or 2) its acquisition is merely a byproduct of the acquisition of the land, the cost in its entirety should be treated as an acquisition of stewardship land; or

c. significant structures that have an operating use (e.g., a constructed hotel or employee housing block) should be treated as general PP&E by identifying the cost attributable to general PP&E and segregating it from the cost of the stewardship land acquired.

38. No amounts for stewardship land acquired through donation or devise[18] should be recognized in the cost of stewardship land.[19]

39. Transfers of stewardship land from one Federal entity to another, does not affect the net cost of operations or net position of either entity. However, in some cases, land included in general PP&E may be transferred to an entity for use as stewardship land. In this instance, the transferring entity should recognize a transfer-out of capitalized assets.[20]

Disclosures and Required Supplementary Information

40. Entities with stewardship land should reference a note[21] on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:

a. A concise statement explaining how it relates to the mission of the entity.

b. A brief description of the entity's stewardship policies for stewardship land. Stewardship policies for stewardship land are the goals and prin-

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[10] Defining physical units as individual items to be counted is neither required nor prohibited. Particularly for collection-type heritage assets, it may be more appropriate to define the physical unit as a collection, or a group of assets located at one facility, and then count the number of collections or facilities.

[11] Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.

[12] See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

[13] SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting*, defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.

[14] SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, clarified that all existing and future standards apply to all Federal entities, including the U.S. Government-wide Financial Statement, unless a standard specifically provides otherwise.

[15] Land rights are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, mineral rights, and other like interests in land.

[16] "Acquired for or in connection with" is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

[17] The Board presently has an active project to address standards for natural resources, for which the Board is considering developing individual standards for each type of natural resource separately. To begin the project, the Board will be addressing oil and gas resources. The framework for the oil and gas resource phase of the project will be used as a model when addressing the other types or logical sets of natural resources (e.g., timber, grazing land, solid leasable minerals) in subsequent phases of the project.

[18] A will or clause of a will disposing of property.

[19] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 258-259 explains that stewardship PP&E is "expensed if purchased, but no amount is recognized if it is received as a donation."

[20] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 and par. 345-346.

[21] This standard does not prescribe a specific reference or line item entitled "Stewardship Land" as it may be included with other items for which no dollar amounts are recognized (such as heritage assets and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.

ciples the entity established to guide its acquisition, maintenance, use, and disposal of stewardship land consistent with statutory requirements, prohibitions, and limitations governing the entity and the stewardship land.

c. A concise description of each major category of stewardship land use. Where parcels of land have more than one use, the predominant use of the land should be considered the major use. In cases where land has multiple uses, none of which is predominant, a description of the multiple uses should be presented. The appropriate level of categorization of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets.

d. Stewardship land should be quantified in terms of physical units. The appropriate level of aggregation and physical units of measure for each major category of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets. For each major category of stewardship land use the following should be reported:

1. The number of physical units by major category of stewardship land use for which the entity is the steward as of the end of the reporting period;
2. The number of physical units by major category of stewardship land use that were acquired and the number of physical units by major category of stewardship land use that were withdrawn during the reporting period; and
3. A description of the major methods of acquisition and withdrawal of stewardship land during the reporting period. This should include disclosure of physical units (by major category of stewardship land use) of transfers of stewardship land between Federal entities and the number of physical units (by major category of stewardship land use) of stewardship land acquired through donation or devise, if material. In addition, the fair value of stewardship land acquired through donation or devise during the reporting period should be disclosed, if known and material.

41. Entities should report the condition[22] of the stewardship land (which may be reported with the deferred maintenance information[23]) as required supplementary information. Entities should include a reference to the condition and deferred maintenance information[24] if reported elsewhere in the report containing the basic financial statements.

U.S. Government-wide Financial Statement Disclosures[25]

42. The U.S. Government-wide financial statement should reference a note on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:

a. A concise statement explaining how it relates to the mission of the Federal Government.

b. A description of the predominant uses of the stewardship land of the Federal Government.

c. A general reference to agency reports for additional information about stewardship land, such as agency stewardship policies for stewardship land, physical units by major categories of stewardship land use, and the condition of the stewardship land.

EFFECTIVE DATE

43. These standards are effective for reporting periods beginning after September 30, 2005 with the exception of the specific paragraphs listed below. These exceptions provide for a phase-in of disclosure requirements being reported as basic information such that these standards will be fully implemented for reporting periods beginning after September 30, 2008.

a. Section c and section d1 in par. 25 and 40 are effective for reporting periods beginning after September 30, 2007;

b. Section d2 and section d3 in par. 25 and 40 are effective for reporting periods beginning after September 30, 2008; and

c. Information that is provided an exception (described in par. a. and b. above) to being reported as basic information during the phase-in period is still required, but should be reported as RSI until the exceptions expire.

44. Full implementation of the standards is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

FASAB Board Members

David Mosso, *Chairman*
Joseph V. Anania, Sr.
Philip T. Calder (through July 31, 2004)
Claire Gorham Cohen
Robert F. Dacey (from August 1, 2004)
John A. Farrell
Joseph L. Kull (through August 31, 2003)
James M. Patton
Robert N. Reid
Elizabeth Robinson
Alan H. Schumacher
David M. Zavada (from December 1, 2003)

[22] Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.

[23] See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

[24] SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting*, defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.

[25] SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, clarified that all existing and future standards apply to all Federal entities, including the U.S. Government-wide Financial Statement, unless a standard specifically provides otherwise.

Statement of Federal Financial Accounting Standards No. 30—Inter-Entity Cost Implementation

(Amending SFFAS 4,* Managerial Cost Accounting Standards and Concepts*)

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

SUMMARY

This standard requires full implementation of the inter-entity cost provision in Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*. By fully implementing the provisions in SFFAS 4 (issued in July 1995) this standard will require the following for inter-entity cost:

> Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services either through billing or other advice.
>
> Recognition of inter-entity costs that are not fully reimbursed is limited to material items that (1) are significant to the receiving entity, (2) form an integral or necessary part of the receiving entity's output, and (3) can be identified or matched to the receiving entity with reasonable precision. Broad and general support services provided by an entity to all or most other entities should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity. (Text preceding paragraph 105 of SFFAS 4)

This standard requires full implementation for reporting periods beginning after September 30, 2008.

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INTRODUCTION

1. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. SFFAS 4 provided for gradual implementation because recognition of the full cost of goods and services provided by one federal entity (the providing entity) to another federal entity (the receiving entity) (1) required adequate cost accounting systems and (2) engaged all federal agencies in identifying the costs of under-reimbursed goods and services.

2. Thus, an orderly means for consistently implementing the standard was viewed as necessary. The Board's implementation guidance provided "the Office of Management and Budget [OMB], with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs."[1] The inter-entity costs were to be specified in accordance with SFFAS 4, including the recognition criteria.[2] It was anticipated that the largest and most important inter-entity costs would be identified first.

3. OMB requested that the Accounting and Auditing Policy Committee (AAPC) provide assistance in developing the guidance anticipated by SFFAS 4. The AAPC Inter-entity Cost Task Force (task force) was formed and initial research was conducted beginning in July 2000. The task force reported its research findings and recommendations to the AAPC at its May 2003 meeting. The task force noted that the current limitation[3] on recognizing inter-entity costs was an impediment to progress towards full costing. However, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. The task force report is available on the AAPC website at http://www.fasab.gov/aapc/iecs.html.

4. This standard follows the extensive research and recommendations by the AAPC task force addressing inter-entity cost guidance. Although the task force report acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing, it recommended continued deferral of SFFAS 4's inter-entity cost requirements while encouraging reimbursable agreements for inter-entity provision of goods and services.

5. This standard is intended to balance the concerns expressed by the task force and the ultimate goals of SFFAS 4 related to full cost. SFFAS 4 clarified that full cost was intended to relate resources to outputs regardless of the funding source:

> The full cost of a responsibility segment's output is the total amount of resources used to produce the output. This includes direct and indirect costs that contribute to the output, regardless of funding sources. It also includes costs of supporting services provided by other responsibility segments or entities. (SFFAS 4, par. 89)

6. Ultimately, attaining full cost is critical to improving performance measurement. SFFAS 4 states:

> Measuring performance is a means of improving program efficiency, effectiveness, and program results. One of the stated purposes of the GPRA of 1993 is to ". . .improve the confidence of the American people in the capability of the federal government, by systematically holding federal agencies accountable for achieving program results." (SFFAS 4, par. 34)
>
> **Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness.** Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness in itself is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost information to show "cost-effectiveness." Thus, the service efforts and accomplishments of a government entity can be evaluated with the following measures:
>
> (1) Measures of service efforts which include the costs of resources used to provide the services and non-financial measures;
>
> (2) Measures of accomplishments which are outputs (the quantity of services provided) and outcomes (the results of those services); and
>
> (3) Measures that relate efforts to accomplishments, such as cost per unit of output or cost-effectiveness. (SFFAS 4, par. 35, emphasis added)
>
> Thus, ..., performance measurement requires both financial and non-financial measures. **Cost is a necessary element for performance measurement, but is not the only element.** (SFFAS 4, par. 36, emphasis added)

7. This standard establishes a date certain—reporting periods beginning after September 30, 2008—for full cost accounting by federal reporting entities. This standard affords time to provide needed guidance before the effective date. The Board anticipates the release of one or more Technical Releases that will address implementation issues during this time. Entities may also use the time period between the issuance of this standard and the actual effective date to establish reimbursable agreements, seek implementation guidance on specific issues if necessary, and develop internal guidance on recognizing inter-entity costs.

[1] SFFAS 4, par. 110.

[2] See SFFAS 4 par. 111-113 for recognition criteria.

[3] To date, OMB has issued guidance for recognizing the following specific inter-entity costs: (1) employees' pension, post-retirement health and life insurance benefits, (2) other post-employment benefits for retired, terminated, and inactive employees, which includes unemployment and workers compensation under the Federal Employees' Compensation Act, and (3) losses in litigation proceedings. The guidance further states that to ensure consistency, agencies should not recognize costs other than those listed until further guidance is provided. See Section 4.3 of OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.*

STANDARDS OF FEDERAL FINANCIAL ACCOUNTING

Amendments to SFFAS 4

Amendments to Existing Standards

8. Statement of Federal Financial Accounting Standard (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*, Inter-Entity Costing, par. 110 is rescinded.

9. The sentence "Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above" is rescinded from par. 111 of SFFAS 4.

Effective Date

10. This standard is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

FASAB Board Members

David Mosso, *Chairman*
Joseph V. Anania, Sr. (through July 15, 2005)
Claire Gorham Cohen
Robert F. Dacey (from August 1, 2004)
John A. Farrell
James M. Patton
Robert N. Reid
Elizabeth Robinson
Alan H. Schumacher
David M. Zavada

SSARS No. 12—Omnibus Statement on Standards for Accounting and Review Services—2005

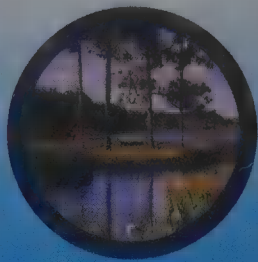
(*Amendment to Statement on Standards for Accounting and Review Services No. 1,* Compilation and Review of Financial Statements, *AICPA,* Professional Standards, *vol. 2, AR sec. 100.05–.10, 100.25, 100.33, 100.38, 100.49–.58, 100.61–.62, and 100.80; rescindment of Interpretation No. 26, "Communicating Possible Fraud and Illegal Acts to Management and Others," of SSARS No. 1,* Compilation and Review of Financial Statements, *AICPA,* Professional Standards, *vol. 2, AR sec. 9100.100–.103; and amendment to SSARS No. 2,* Reporting on Comparative Financial Statements, *AICPA,* Professional Standards, *vol. 2, AR sec. 200.25–.27*)

Amendment to Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.05–.10, 100.25, 100.38, and 100.61–.62)—The Accountant's Consideration of Fraud and Illegal Acts in a Compilation or Review Engagement

1. Guidance in Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.05), states that the accountant should,

(continued on page 112)

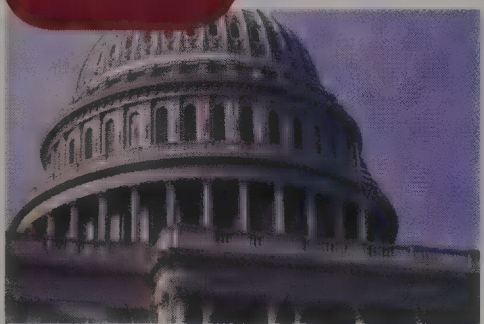





AICPA conferences

AICPA National Conference on Current SEC & PCAOB Developments

4 Locations!



December 5–7, 2005

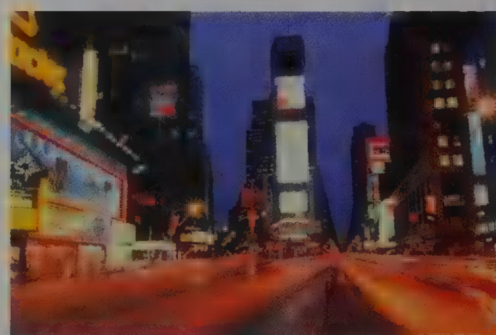
Live Event:
Marriott Wardman Park Hotel
Washington, DC

CPE Credits: up to 24

Conference Highlights:
- SEC/PCAOB/FASB/AcSEC updates and observations
- Section 404 lessons learned
- Smaller public company issues including guidance for non-accelerated filers
- Corporate governance and MD&A
- Technical accounting issues
- International issues and convergence

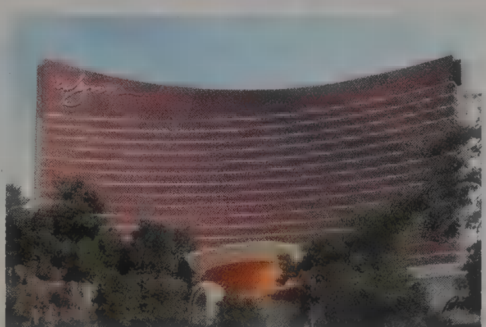
***NEW* Video Simulcast:**
Hyatt Regency O'Hare
Chicago, IL

***NEW* Video Simulcast:**
Grand Hyatt San Francisco
on Union Square
San Francisco, CA



Video Simulcast:
New York Marriott Marquis
New York, NY

AICPA National Construction Industry Conference



December 8–9, 2005

Wynn Las Vegas
Las Vegas, NV

CPE Credits: 19 (main) and up to 3 (optional)
Post-Conference Optional Workshops:
Saturday, December 10

Conference Highlights:
- Many technical accounting topics, including: FASB Update, FIN 46, revenue recognition and accounting for risk management products
- Important tax topics including IRS Update and tax updates for small and large contractors
- A leading panel of experts discuss recent events in this industry
- The latest products and services from premier vendors will be on display in the exhibit hall

among other things, establish an understanding with the entity that provides that the accountant will inform the appropriate level of management of any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential. This amendment revises SSARS No. 1 by requiring the accountant to:

a. Establish an understanding with the client, preferably in writing, that the accountant will inform the appropriate level of management of any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred.

b. Report, to the appropriate level of management, any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred.

The accountant need not report matters regarding illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such items to be communicated.

For purposes of this Statement, *fraud* is defined as an intentional act that results in a misstatement in compiled or reviewed financial statements and *illegal acts* are defined as violations of laws or government regulations, excluding fraud. New language is shown in boldface italics; deleted language is shown by strikethrough.

Understanding With the Entity

.05 The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. However, if the engagement is to compile financial statements not expected to be used by a third party, a written communication is required. (See paragraphs .20 and .21.) The understanding should include a description of the nature and limitations of the services to be performed and a description of the report, if a report is to be issued. The understanding should also provide:

~~(a.)~~ ***T***~~t~~hat the engagement cannot be relied upon to disclose errors, fraud,[10] or illegal acts[11] and

~~(b.)~~ ***T***~~t~~hat the accountant will inform the appropriate level of management~~10~~[12] of any material errors ***and of any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures[13] that fraud or an illegal act may have occurred.[14] The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.*** ~~that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential.~~ Examples of engagement letters are presented in Appendixes C, D, and E.

10. For purposes of this Statement, **fraud** ***is an intentional act that results in a misstatement in compiled or reviewed financial statements.***

11. For purposes of this Statement, **illegal acts** ***are violations of laws or government regulations, excluding fraud.***

~~10~~***12***. ~~When a fraud or illegal act involves senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors.~~

13. Compilation performance requirements are contained in paragraphs .07 through .10. Review performance requirements are contained in paragraphs .26 through .38.

14. Whether an act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on financial statements, presents himself or herself as one who is proficient in accounting and compilation or review services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

Compilation of Financial Statements

.06 Paragraphs .07 through .10 are applicable to a compilation of financial statements, whenever the accountant—

- Is engaged to report on compiled financial statements.
- Submits financial statements to a client that are or reasonably might be expected to be used by a third party.
- Submits financial statements to a client that are not expected to be used by a third party.

Compilation Performance Requirements

.07 The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him or her to compile financial statements that are appropriate in form for an entity operating in that industry.~~11~~[15] This standard does not prevent an accountant from accepting a compilation engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry.

.08 To compile financial statements, the accountant should possess a general understanding of the nature of the entity's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. The accountant ordinarily obtains knowledge of these matters through experience with the entity or inquiry of the entity's personnel. On the basis of that understanding, the accountant should consider whether it will be necessary to perform other accounting services, such as assist in adjusting the books of account or consult on accounting matters, when he or she compiles financial statements.

.09 The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have made inquiries or performed other procedures. The results of such inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. ***If any evidence or information comes to the accountant's attention regarding fraud or an illegal act that may have occurred, the accountant should request that management consider the effect of the matter on the financial statements. Additionally, the accountant should consider the effect of the matter on his or her compilation report.*** In ~~such~~ circumstances ***where the accountant believes that the financial statements are materially misstated***, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should withdraw from the engagement. (However, see paragraphs .16 through .18 for guidance when management elects to omit substantially all the disclosures required by GAAP and see paragraphs .~~45~~***46*** through .~~47~~***48*** for the accountant's reporting responsibilities when he or she is aware of other departures from GAAP.)

~~11~~*15*. For purposes of this Statement, the term *industry* includes governmental and not-for-profit activities.

.10 Before submission, the accountant should read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term *error* refers to mistakes in the compilation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosure.

***

Review of Financial Statements

.25 A review does not contemplate obtaining an understanding of internal control or assessing control risk, ***assessing fraud risks***, tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, ***performance of procedures designed to detect material misstatements due to fraud or illegal acts,*** and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. However, ~~if~~ the accountant ***may*** becomes aware that information coming to his or her attention is incorrect, incomplete, or otherwise unsatisfactory~~,~~***. If any evidence or information comes to the accountant's attention regarding fraud or an illegal act that may have occurred, the accountant should request that management consider the effect of the matter on the financial statements. Additionally, the accountant should consider the effect of the matter on his or her review report. In circumstances where the accountant believes the financial statements are materially misstated,*** the accountant should perform the additional procedures deemed necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (See paragraph .~~42~~***43*** for guidance when an accountant is unable to complete a review and paragraphs .~~45~~***46*** through .~~47~~***48*** for the accountant's responsibilities when he or she is aware of departures from generally accepted accounting principles.)

***

Documentation in a Review Engagement

~~.37~~ *38* The documentation of the inquiry and analytical procedures should include the following:

a. The matters covered in the accountant's inquiry procedures.

b. The analytical procedures performed.

c. The expectations as discussed in paragraph .29, where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in the development of those expectations.

d. Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts.

e. Any additional procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures.

f. Unusual matters that the accountant considered during the performance of the review procedures, including their disposition.

g. Communications, whether oral or written, to the appropriate level of management regarding fraud or illegal acts that come to the accountant's attention.

~~*g.*~~ ***h.*** The representation letter.

***

Communicating to Management and Others

.61 When evidence or information comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred,[36] that matter should be brought to the attention of the appropriate level of management. The accountant need not report matters regarding illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated. When matters regarding fraud or an illegal act involve senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors. The communication may be oral or written. If the communication is oral, the accountant should document it. When matters regarding fraud or an illegal act involve an owner of the business, the accountant should consider resigning from the engagement.[37] Additionally, the accountant should consider consulting with his or her legal counsel and insurance provider whenever any evidence or information comes to his or her attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred, unless such illegal act is clearly inconsequential.

.62 The disclosure of any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures that fraud or [redacted] illegal act may have occurred to parties other than the client's senior management (or the client's board of directors, if applicable) ordinarily is not part of the accountant's responsibility and ordinarily would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances [redacted] duty to disclose to parties outside of the entity may exist:

a. To comply with certain legal and regulatory requirements

b. To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with SSARS No. 4,* Communications Between Predecessor and Successor Accountants *(AICPA,* Professional Standards, *vol. 2, AR sec. 400), as amended, regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity

c. In response to a subpoena

Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing matters covered by paragraph .61 with parties outside the client.

Subsequent and intervening paragraphs and footnotes are renumbered.

2. This amendment is effective for compilations and reviews of financial statements for periods ending after December 15, 2005. Early application is permitted.

[redacted] to [redacted] on Standards [redacted] Accounting and [redacted] Services [redacted] 1, *Compilation* [redacted] *of* [redacted] *Statements* (AICPA, [redacted] *Standards*, vol. 2, [redacted] 100.33 and [redacted]—The Accountant's [redacted] of Obtaining [redacted] Updating Representation [redacted] Management

3. SSARS do not provide guidance on when an accountant should obtain an updating representation letter from management. This amendment revises SSARS No. 1 to provide such guidance, by adding a paragraph in the section titled "Management Representations" and an illustrative updating management representation letter in a new Appendix G. New language is shown in boldface italics.

.33 There are circumstances in which [redacted] accountant should consider obtaining [redacted] updating representation letter from management (for example, the accountant obtains a management representation letter after completion of inquiry and analytical review procedures but does not issue his or her review report for [redacted] significant period of time thereafter, or a material subsequent event occurs after the completion of inquiry and analytical review procedures, including obtaining the original management representation letter, but before the issuance of the report [redacted] the reviewed financial statements). In addition, if a predecessor accountant is requested by a former client to reissue his or her report on the financial statements of a prior period, and those financial statements are to be presented on a comparative basis with reviewed financial statements of a subsequent period, the predecessor accountant should obtain [redacted] updating representation letter from the management of the former client.[24] The updating management representation letter should state (a) whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified and (b) whether any events have occurred subsequent to the balance-sheet date of the latest financial statements reported on by the accountant that would require adjustment to or disclosure in those financial statements.[25]

***

24. See SSARS No. 2, Reporting [redacted] Comparative Financial Statements *(AICPA,* Professional Standards, *vol. 2, AR sec. 200.20–.24).*

25. An illustrative updating management representation letter is contained in Appendix G, "Review of Financial Statements—Illustrative Updating Management Representation Letter."

[redacted]
[redacted]
[redacted] of [redacted] Statements— [redacted] Updating Management Representation [redacted]

The following letter is presented for illustrative purposes only. It may be used in the circumstances described in paragraph .33 of this section. Management need not repeat all of the representations made in the previous representation letter.

If matters exist that should be disclosed to the accountant, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the accountant's review report is disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred…"

[Date][1]

To [Accountant]

In connection with your review(s) of the [identification of financial statements] of [name of entity] as of [dates] and for the [periods of review] for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements for them to be in conformity with generally accepted accounting principles, you were previously provided with [redacted] representation letter under date of [date of previous representation letter]. No information has come to our attention that would cause [redacted] to believe that any of those previous representations should be modified.

To the best of our knowledge and belief, no events have occurred subsequent to [date of latest balance sheet reported on by the accountant or date of previous representation letter] and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

____

[Name of Owner or Chief Executive Officer and Title]

____

[Name of Chief Financial Officer and Title, where applicable]

36. See Interpretation No. 6, "Withdrawal From Compilation or Review Engagement," of SSARS No. 1 (AR sec. 9100.18–.22) for guidance [redacted] the circumstances under which the accountant would ordinarily conclude that it is necessary to withdraw from [redacted] compilation or review engagement.

37. If the evidence or information indicates that fraud or an illegal act extends to prior-period financial statements, see Interpretation No. 4, "Discovery of Information After the Date of the Accountant's Report," of SSARS No. 1 (AR sec. 9100.13–.15).

1. The accountant has two methods available for dating the report when a subsequent event requiring disclosure occurs after the completion of the review but before issuance of the report on the related financial statements. The accountant may use "dual dating," for example, "February 16, 20XX, except for Note Y, as to which the date is March 1, 20XX," or may date the report as of the later date.

Subsequent paragraphs and footnotes are renumbered.

4. This amendment is effective for reviews of financial statements for periods ending after December 15, 2005. Early application is permitted.

Amendment to Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards,* vol. 2, AR sec. 100.49–.58)—Restricting the Use of an Accountant's Compilation or Review Report

5. This amendment revises SSARS No. 1 to provide guidance to accountants on restricting the use of reports issued pursuant to SSARS. This amendment:

- Defines the terms *general use* and *restricted use.*
- Describes the circumstances in which the use of accountant's reports should be restricted.
- Specifies the language to be used in accountant's reports that are restricted regarding use.

New language is shown in boldface italics.

Restricting the Use of an Accountant's Compilation or Review Report

General-Use and Restricted-Use Reports

.49 The term general use applies to accountant's reports that are not restricted to specified parties. Accountant's reports on financial statements prepared in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles ordinarily are not restricted regarding use.[31]

.50 The term restricted use applies to accountant's reports intended only for one or more specified third parties. The need for restriction on the use of a report may result from a number of circumstances, including, but not limited to, the purpose of the report and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used.

.51 An accountant should restrict the use of a report when the subject matter of the accountant's report or the presentation being reported on is based on measurement or disclosure criteria contained in contractual agreements[32] or regulatory provisions that are not in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.[33]

31. Nothing in this Statement precludes an accountant from restricting the use of any report.

32. A contractual agreement as discussed in this Statement is an agreement between the client and one or more third parties other than the accountant.

33. When the contractual agreement or regulatory provision specifies the use of a prescribed form for which the accountant has been engaged to compile the financial statements, the accountant should reference SSARS No. 3, Compilation Reports on Financial Statements Included in Certain Prescribed Forms *(AICPA,* Professional Standards, *vol. 2, AR sec. 300), for an alternative form of standard compilation report when the prescribed form calls for a departure from generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.*

Reporting on Subject Matter or Presentations Based on Measurement or Disclosure Criteria Contained in Contractual Agreements or Regulatory Provisions

.52 When reports are issued on subject matter or presentations based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions that are not in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles, the accountant should restrict the report because the basis, assumptions, or purpose of such presentations (contained in such agreements or regulatory provisions) are developed for and directed only to the parties to the agreement or regulatory agency responsible for the provisions and because the report, the subject matter, or the presentation may be misunderstood by those who are not adequately informed of the basis, assumptions, or purpose of the presentation.

Combined Reports Covering Both Restricted-Use and General-Use Subject Matter or Presentations

.53 If an accountant issues a single combined report covering both (a) subject matter or presentations that require a restriction on use to specified parties and (b) subject matter or presentations that ordinarily do not require such a restriction, the use of such a single combined report should be restricted to the specified parties.

Inclusion of a Separate Restricted-Use Report in the Same Document With a General-Use Report

.54 Where required by law or regulation, a separate restricted-use report may be included in a document that also contains a general-use report. The inclusion of a separate restricted-use report in a document that contains a general-use report does not affect the intended use of either report. The restricted-use report remains restricted as to use, and the general-use report continues for general use.

Adding Other Specified Parties

.55 Subsequent to the completion of an engagement resulting in a restricted-use report, or in the course of such an engagement, an accountant may be asked to consider adding other parties as specified parties.

.56 If an accountant is reporting on subject matter or a presentation based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions, as described in paragraph .52, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties, their knowledge of the basis of the measurement or disclosure criteria, and the intended use of the report. If the accountant agrees to add other parties as specified parties, the accountant should obtain affirmative acknowledgment, preferably in writing, from the other parties of their understanding of the nature of the engagement, the measurement or disclosure criteria used in the engagement, and the related report. If the other parties are added after the accountant has issued his or her report, the report may be reissued or the accountant may provide other written acknowledgment that the other parties have been added as specified parties. If the report is reissued, the report date should not be changed. If the accountant provides written acknowledgment that the other parties have been added as specified parties, such written acknowledgment ordinarily should state that no procedures have been performed subsequent to the date of the report.

Limiting the Distribution of Reports

.57 Because of the reasons presented in paragraph .50, an accountant should consider informing his or her client that restricted-use reports are not intended for distribution to nonspecified parties, regardless of whether they are included in a document containing a separate general-use report.[34] This Statement does not preclude an accountant, in connection with establishing the terms of the engagement, from reaching an understanding with the client that the intended use of the report will be restricted, and from obtaining the client's agreement that the client and the specified parties will not distribute the report to parties other than those identified in the report. However, an accountant is not responsible for controlling a client's distribution of restricted-use reports. Accordingly, a restricted-use report should alert readers to the restriction on the use of the report by indicating that the report is not intended to be and should not be used by anyone other than the specified parties.

34. In some cases, restricted-use reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency as part of its oversight responsibility for an entity may require access to restricted-use reports in which they are not named as a specified party.

Report Language—Restricted Use

.58 An accountant's report that is restricted as to use should contain a separate paragraph at the end of the report that includes the following elements:

a. A statement indicating that the report is intended solely for the information and use of the specified parties

b. An identification of the specified parties to whom use is restricted

c. A statement that the report is not intended to be and should not be used by anyone other than the specified parties

An example of such a paragraph is the following:

This report is intended solely for the information and use of [the specified parties][35] ***and is not intended to be and should not be used by anyone other than these specified parties.***

35. The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.

Subsequent paragraphs and footnotes are to be renumbered.

6. This amendment is effective upon issuance.,

Amendment to Statement on Standards for Accounting and Review Services No. 2, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200.25–.27)—Restated Prior-Period Financial Statements

7. Guidance in the section titled "Changed Prior-Period Financial Statements" in SSARS No. 2, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200.25–.26), requires that either the predecessor or successor accountant report on changed prior-period financial statements, as restated. The successor accountant is precluded from reporting on the restatement adjustment only. This amendment revises SSARS No. 2 to allow the successor accountant to report on the restatement adjustment while indicating that a predecessor accountant reported on the financial statements of the prior period before restatement. New language is shown in boldface italics; deleted language is shown by strikethrough.

~~Changed~~ ***Restated*** Prior-Period Financial Statements

~~.25 When the financial statements of the prior period have been changed, either the predecessor or the successor should report on them as restated. If the predecessor accepts the reporting obligation, he should follow the guidance in paragraphs .20 to .24. If the successor reports on the financial statements, he should comply with the compilation or review standards in SSARS No. 1 (or perform an audit) with respect to such restated prior-period financial statements and report on them accordingly. If a successor reports on the restated financial statements, he should not refer in his report to the predecessor's previously issued report.~~

~~.26 If the restatement does not involve a change in accounting principles or their application (for example, the correction of an error), the accountant may wish to include an explanatory paragraph in his report with respect to the restatement, but he should not otherwise modify his standard report provided the financial statements appropriately disclose such matters.~~

.25 When prior-period financial statements have been restated,[10] the predecessor accountant would normally reissue his or her report following the guidance in paragraph .22. If the predecessor decides not to reissue his or her report, the successor accountant may be engaged to report on the financial statements for the prior year. If the predecessor accountant does not reissue his or her report and the successor accountant is not engaged to report on the prior year financial statements, the successor accountant should indicate in the introductory paragraph of his or her compilation or review report that a predecessor accountant reported on the financial statements of the prior period before restatement. In addition, if the successor accountant is engaged to compile or review the restatement adjustment(s), he or she may also indicate in the accountant's report that he or she compiled or reviewed the adjustment(s) that was (were) applied to restate prior-year financial statements.

.26 The following is an example of a successor accountant's compilation report when the predecessor accountant's report is not presented and the successor accountant is engaged to compile the restatement adjustment(s):

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. I (we) also compiled the adjustment(s) described in Note X[11] that was (were) applied to restate the 20X1 financial statements. The 20X1 financial statements of XYZ Company, before the adjustment(s) described in Note X[11] that was (were) applied to restate the 20X1 financial statements, were compiled by other accountants whose report dated March 31, 20X2, did not express an opinion or any other form of assurance on those financial statements.

[Same second paragraph as the standard report]

.27 The following is an example of a successor accountant's review report when the predecessor accountant's report is not presented and the successor accountant is engaged to review the restatement adjustment(s):[12]

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company. The 20X1 financial statements of XYZ before the adjustment(s) described in Note X that was (were) applied to restate the 20X1 financial statements were reviewed by other accountants whose report dated March 31, 20X2, stated that they were not aware of any material modifications that should be made to those financial statements in order for them to be in conformity with generally accepted accounting principles.

[Same second and third paragraphs as the standard report]

I (we) also reviewed the adjustment(s) as described in Note X that was (were) applied to restate the 20X1 financial statements. Based on my (our) review, nothing came to my (our) attention to indicate that the adjustment(s) is (are) not appropriate and properly applied.

Subsequent paragraphs and footnotes are renumbered.

8. This amendment is effective for compilations and reviews of financial statements for periods ending after December 15, 2005. Early application is permitted.

This Statement titled Omnibus Statement on Standards for Accounting and Review Services—2005 *was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee.*

Accounting and Review Services Committee (2004–2005)

Andrew M. Cohen, *Chair*
Suzanne M. Heidenreich
Henry Krostich
John J. Malahoski
Thomas A. Ratcliffe
Walter H. Webb
Mark E. Ziessman

AICPA Staff

Charles E. Landes
Vice President
Professional Standards
Michael P. Glynn
Technical Manager
Audit and Attest Standards

Note: *Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical body of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Rule 202,* Compliance With Standards, *of the Institute's Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARS.*

SSARS No. 13—Compilation of Specified Elements, Accounts, or Items of a Financial Statement

(AICPA, *Professional Standards*, vol. 2, AR sec. 110)

(Rescindment of Interpretation No. 8, "Reports on Specified Elements, Accounts, or Items of a Financial Statement," of SSARS No. 1,* Compilation and Review of Financial Statements, *AICPA,* Professional Standards, *vol. 2, AR sec. 9100.27–.28)

10. *See SSARS No. 4,* Communications Between Predecessor and Successor Accountants *(AICPA,* Professional Standards, *vol. 2, AR sec. 400.10–.11) for guidance regarding communication to the predecessor accountant with respect to information that leads the successor accountant to believe that the financial statements reported on by the predecessor accountant may require revision.*

11. *In the situation where management elects to omit substantially all disclosures, the accountant should follow the guidance in SSARS No. 1,* Compilation and Review of Financial Statements *(AICPA,* Professional Standards, *vol. 2, AR sec. 100.16–.18), as amended.*

12. *The accountant should follow the performance requirements in SSARS No. 1 (AR sec. 100.26–.38), as amended.*

1. Statements on Standards for Accounting and Review Services (SSARS) currently provide guidance concerning the standards and procedures applicable when an accountant submits unaudited financial statements to his or her client or third parties. By definition, presentations of specified elements, accounts, or items of a financial statement are not financial statements. This Statement expands SSARS to apply when an accountant is engaged to compile or issues a compilation report on one or more specified elements, accounts, or items of a financial statement.

2. A compilation of one or more specified elements, accounts, or items of a financial statement is limited to presenting financial information that is the representation of management (owners) without undertaking to express any assurance on that information. (The accountant might consider it necessary to perform other accounting services to compile the financial information.)

3. Examples of specified elements, accounts, or items of a financial statement that an accountant may compile include schedules of rentals, royalties, profit participation, or provision for income taxes.

CONDITIONS FOR COMPILING SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF A FINANCIAL STATEMENT

4. Nothing in this Statement is intended to preclude an accountant from preparing or assisting in the preparation of one or more specified elements, accounts, or items of a financial statement and submitting such specified elements, accounts, or items of a financial statement to the client without the issuance of a compilation report, unless the accountant has been engaged to compile such specified elements, accounts, or items of a financial statement. If an accountant prepares or assists a client in preparing a schedule of one or more specified elements, accounts, or items of a financial statement,[1] the accountant should consider how such a presentation of specified elements, accounts, or items will be used. The accountant should consider the potential of being associated with the schedule and the likelihood that the user may inappropriately infer, through that association, an unintended level of assurance. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer a level of assurance that does not exist.

5. An engagement to compile one or more specified elements, accounts, or items of a financial statement may be undertaken as a separate engagement or in conjunction with a compilation of financial statements.

UNDERSTANDING WITH THE ENTITY

6. When an accountant is engaged to compile one or more specified elements, accounts, or items of a financial statement, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report. The understanding should also provide:

a. That the engagement cannot be relied upon to disclose errors, fraud,[2] or illegal acts,[3] and

b. That the accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the engagement to compile one or more specified elements, accounts, or items of a financial statement[4] that fraud or an illegal act may have occurred.[5] The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

7. When the accountant is engaged to compile one or more specified elements, accounts, or items of a financial statement and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant must adhere to the communication requirements contained in SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.61–.62), as amended.

PERFORMANCE REQUIREMENTS

8. When the accountant is engaged to compile or issues a compilation report on one or more specified elements, accounts, or items of a financial statement, he or she must adhere to the compilation performance requirements contained in SSARS No. 1 (AR sec. 100.07–.10), as amended.

9. Before issuance of a compilation report on one or more specified elements, accounts, or items of a financial statement, the accountant should read such compiled specified elements, accounts, or items of a financial statement and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the specified elements, accounts, or items of a financial statement, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including disclosures, if presented.

REPORTING REQUIREMENTS

10. When the accountant is engaged to compile or issues a compilation report on one or more specified elements, accounts, or items of a financial statement, the basic elements of the report are as follows:

a. A statement that the specified element(s), account(s), or item(s) identified in the report were compiled. If the compilation was performed in conjunction with a compilation of the company's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the specified element(s), account(s), or item(s).

b. A statement that the compilation was performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

c. A description of the basis on which the specified element(s), account(s), or item(s) are presented if that basis is not generally accepted accounting principles and a statement that that basis of presentation is a comprehensive basis of accounting other than generally accepted accounting principles.

d. A statement that a compilation is limited to presenting financial information that is the representation of management (owners).

e. A statement that the specified element(s), account(s), or item(s) have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on it (them).

f. A signature of the accounting firm or the accountant as appropriate. (The signature could be manual, stamped, electronic, or typed.)

g. The date of the compilation report. (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

11. Each page of the compiled specified elements, accounts, or items of a financial statement should include a reference, such as "See Accountant's Compilation Report."

12. Following are illustrations of accountant's compilation reports on specified elements, accounts, or items of a financial statement.

Report Related to Accounts Receivable

I (we) have compiled the accompanying schedule of accounts receivable of XYZ Company as of December 31, 20XX, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying

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[1] If the specified element, account, or item of a financial statement is included as accompanying information to the basic financial statements, the accountant should refer to Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.60), as amended.

[2] For purposes of this Statement, *fraud* is an intentional act that results in a misstatement in compiled specified elements, accounts, or items of a financial statement.

[3] For purposes of this Statement, *illegal acts* are violations of laws or government regulations, excluding fraud.

[4] Performance requirements with respect to an engagement to compile one or more specified elements, accounts, or items of a financial statement are contained in paragraphs 8 and 9.

[5] Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on one or more specified elements, accounts, or items of a financial statement, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

schedule of accounts receivable and, accordingly, do not express an opinion or any other form of assurance on it.

Report Related to the Schedule of Depreciation—Income Tax Basis

I (we) have compiled the accompanying schedule of depreciation—income tax basis of XYZ Company as of December 31, 20XX, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The schedule of depreciation—income tax basis has been prepared on the accounting basis used by the Company for federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying schedule of depreciation—income tax basis and, accordingly, do not express an opinion or any other form of assurance on it.

13. An accountant is not precluded from issuing a compilation report on one or more specified elements, accounts, or items of a financial statement for an entity with respect to which the accountant is not independent.[6] If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

14. This Statement is effective for engagements entered into after December 15, 2005. Early application is permitted.

This Statement titled Compilation of Specified Elements, Accounts, or Items of a Financial Statement *was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee.*

Accounting and Review Services Committee (2004–2005)

Andrew M. Cohen, *Chair*
Suzanne M. Heidenreich
Henry Krostich
John J. Malahoski
Thomas A. Ratcliffe
Walter H. Webb
Mark E. Ziessman

AICPA Staff

Charles E. Landes
Vice President
Professional Standards
Michael P. Glynn
Technical Manager
Audit and Attest Standards

Note: *Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical body of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Rule 202,* Compliance With Standards, *of the Institute's Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARS.*

[6] In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA *Code of Professional Conduct.*

SSARS No. 14—Compilation of Pro Forma Financial Information

(AICPA, *Professional Standards*, vol. 2, AR sec. 120)

1. Statements on Standards for Accounting and Review Services (SSARS) currently provide guidance concerning the standards and procedures applicable when an accountant submits unaudited financial statements to his or her client or third parties. By definition, presentations of pro forma financial information are not financial statements. This Statement expands SSARS to apply when an accountant is engaged to compile or issues a compilation report on pro forma financial information.

2. A compilation of pro forma financial information is limited to presenting financial information that is the representation of management (owners) without undertaking to express any assurance on that information. (The accountant might consider it necessary to perform other accounting services to compile the financial information.)

3. The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

4. This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event).

5. Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation should also indicate that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

CONDITIONS FOR COMPILING PRO FORMA FINANCIAL INFORMATION

6. Nothing in this Statement is intended to preclude an accountant from preparing or assisting in the preparation of pro forma financial information and submitting such pro forma financial information to the client without the issuance of a compilation report, unless the accountant has been engaged to compile such pro forma financial information. If an accountant prepares or assists a client in preparing pro forma financial information,[1] the accountant should consider how such a presentation of pro forma financial information will be used. The accountant should consider the potential of being associated with pro forma financial information and the likelihood that the user may inappropriately infer, through that association, an unintended level of assurance. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer a level of assurance that does not exist.

7. An engagement to compile pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation of financial statements. The accountant may agree to compile pro forma financial information if the document that contains the pro forma financial information includes (or incorporates by reference) complete historical financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) and, if pro forma financial information is presented for an interim period, the document also includes (or incorporates by reference) historical interim financial information for that period (which may be presented in condensed form). In the case of a business combination, the document should include (or incorporate by reference) the appropriate historical financial information for the significant constituent parts of the combined entity.

8. Additionally, the historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is

(continued on page 120)

[1] If the pro forma financial information is included as accompanying information to the basic financial statements, the accountant should refer to Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.60), as amended.

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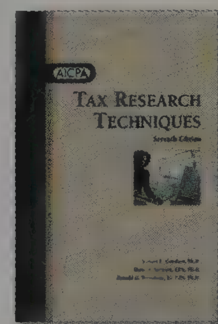

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based must have been compiled, reviewed, or audited. The accountant's compilation or review report or the auditor's report on the historical financial statements should be included (or incorporated by reference) in the document containing the pro forma financial information.

UNDERSTANDING WITH THE ENTITY

9. When an accountant is engaged to compile pro forma financial information, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report. The understanding should also provide:

a. That the engagement cannot be relied upon to disclose errors, fraud,[2] or illegal acts[3] and

b. That the accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the engagement to compile pro forma financial information[4] that fraud or an illegal act may have occurred.[5] The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

10. When the accountant is engaged to compile pro forma financial information and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant must adhere to the communication requirements contained in SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.61–.62), as amended.

PERFORMANCE REQUIREMENTS

11. When the accountant is engaged to compile or issues a compilation report on pro forma financial information, he or she must adhere to the compilation performance requirements contained in SSARS No. 1 (AR sec. 100.07–.10), as amended.

12. Before issuance of a compilation report on pro forma financial information, the accountant should read such compiled pro forma financial information, including the summary of significant assumptions,[6] and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term error refers to mistakes in the compilation of the pro forma financial information, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including disclosures, if presented.

REPORTING REQUIREMENTS

13. When the accountant is engaged to compile or issues a compilation report on pro forma financial information, the basic elements of the report are as follows:

a. An identification of the pro forma financial information.

b. A statement that the compilation was performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

c. A reference to the financial statements from which the historical financial information is derived and a statement on whether such financial statements were compiled, reviewed, or audited. (The report on pro forma financial information should refer to any modifications in the accountant's or auditor's report on historical financial statements.)

d. A statement that the pro forma financial information was compiled. If the compilation was performed in conjunction with a compilation of the company's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the pro forma financial information.

e. A description of the basis on which the pro forma financial information is presented if that basis is not generally accepted accounting principles and a statement that that basis of presentation is a comprehensive basis of accounting other than generally accepted accounting principles.

f. A statement that a compilation is limited to presenting pro forma financial information that is the representation of management (owners).

g. A statement that the pro forma financial information has not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on it.

h. A separate paragraph explaining the objective of pro forma financial information and its limitations.

i. A signature of the accounting firm or the accountant as appropriate. (The signature could be manual, stamped, electronic, or typed.)

j. The date of the compilation report. (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

14. Each page of the compiled pro forma financial information should include a reference, such as "See Accountant's Compilation Report."

15. The following is an illustration of an accountant's compilation report on pro forma financial information.

> I (we) have compiled the accompanying pro forma financial information as of and for the year ended December 31, 20XX, reflecting the business combination of the Company and ABC Company in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The historical condensed financial statements are derived from the historical unaudited financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were compiled by another (other) accountant(s).[7]
>
> A compilation is limited to presenting pro forma financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying pro forma financial information and, accordingly, do not express an opinion or any other form of assurance on it.
>
> The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date. However, the pro forma financial information is not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction (or event) actually occurred earlier.
>
> [*If the presentation does not include all applicable disclosures, the following paragraph should be added.*][8]
>
> Management has elected to omit all of the disclosures ordinarily included in pro forma financial information. The omitted disclosures might have added significant information regarding the company's pro forma financial position and results of operations. Accordingly, this pro forma financial information is not designed for those who are not informed about such matters.

16. An accountant is not precluded from issu-

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[2] For purposes of this Statement, *fraud* is an intentional act that results in a misstatement in compiled pro forma financial information.

[3] For purposes of this Statement, *illegal acts* are violations of laws or government regulations, excluding fraud.

[4] Performance requirements with respect to an engagement to compile pro forma financial information are contained in paragraphs 11 and 12.

[5] Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on pro forma financial information, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

[6] The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented. Nothing in this Statement should be interpreted to preclude the accountant from reporting on compiled pro forma financial information when management elects to omit substantially all disclosures. In that situation, the accountant should follow the guidance in SSARS No. 1 (AR sec. 100.16–.18), as amended.

[7] Where one set of historical financial statements is audited or reviewed and the other is audited, reviewed, or compiled, wording similar to the following would be appropriate:

> The historical condensed financial statements are derived from the historical financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were reviewed by another (other) accountant(s), appearing elsewhere herein (or incorporated by reference).

If either accountant's review report or auditor's report includes an explanatory paragraph or is modified, that fact should be referred to within this report.

[8] The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented.

ing a compilation report on pro forma financial information for an entity with respect to which the accountant is not independent.[9] If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

17. This Statement is effective for engagements entered into after December 15, 2005. Early application is permitted.

This Statement titled Compilation of Pro Forma Financial Information *was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee.*

Accounting and Review Services [redacted] (2004–2005)

Andrew M. Cohen, *Chair*
Suzanne M. Heidenreich
Henry Krostich
John J. Malahoski
Thomas A. Ratcliffe
Walter H. Webb
Mark E. Ziessman

[redacted]

Charles E. Landes
Vice President
Professional Standards
Michael P. Glynn
Technical Manager
Audit and Attest Standards

Note: *Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical body of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Rule 202,* Compliance With Standards, *of the Institute's Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARS.*

[9] In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA *Code of Professional Conduct.*

[redacted] Interpretation

Interpretations are issued by the Accounting and Review Services Committee (ARSC) to provide guidance on the application of Statements on Standards for Accounting and Review Services (SSARSs). Interpretations are issued after all ARSC members have been provided an opportunity to consider and comment on whether the Interpretation is consistent with SSARSs. An Interpretation is not as authoritative as a SSARS, but members should be aware that they may have to justify a departure from an Interpretation if the quality of their work is questioned.

[redacted]

Interpretation [redacted] Section 100, "Compilation [redacted] Statements"

27. Applicability of Statements on Standards for Accounting and Review Services to Reviews of Nonissuers Who Are Owned by or Controlled by [redacted] Issuer

.104 *Question*—A subsidiary of an issuer[15] has requested that its financial statements be reviewed for the purpose of providing those subsidiary financial statements and the accountant's review report to a local bank as a condition of a new borrowing arrangement. Because the entity is a subsidiary of a public company, its auditors have applied auditing and review procedures in accordance with the professional standards of the Public Company Accounting Oversight Board (PCAOB) at the subsidiary level.

What authoritative standards should an accountant follow when engaged to review the separate financial statements of a subsidiary, which itself is not an issuer?

.105 *Interpretation*—SSARS No. 1 [section 100.04] defines a nonpublic entity as:

Any entity other than (*a*) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally; (*b*) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market; or (*c*) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (*a*) or (*b*).

.106 The condition set forth in (*c*) above is intended to be read in the context of when the review of the subsidiary, corporate joint venture, or other entity is being performed for the purpose of the controlling entity (the issuer) meeting its reporting obligations as a result of conditions (*a*) or (*b*).

.107 For example, if a subsidiary is being reviewed at an interim period as part of an entity's filing of its consolidated interim financial statements with the Securities and Exchange Commission (SEC), then the review should be performed in accordance with PCAOB standards and SSARSs are not applicable because the review is in the context of the issuer meeting its reporting obligations as a result of conditions (*a*) or (*b*).

.108 However, in the situation where an accountant is engaged to review the financial statements of a subsidiary, corporate joint venture, or other entity that is not itself an issuer and the review report and reviewed financial statements are not being filed with the SEC, or another regulatory agency that requires the accountant to prepare the review report in accordance with PCAOB standards, the accountant should perform the review in accordance with SSARSs since the review engagement is not being performed in the context of the issuer meeting its reporting obligations as a result of conditions (*a*) or (*b*).

[15] An "issuer" as defined in section 2 of the Sarbanes-Oxley Act of 2002 means "an issuer (as defined in section 3 of the Securities and Exchange Act of 1934), the securities of which are registered under section 12 of that Act, or that is required to file reports under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn."

Auditing Interpretations

Auditing Interpretations of Statements on Auditing Standards (SASs) are Interpretive Publications *pursuant to AU section 150,* Generally Accepted Auditing Standards [of AICPA Professional Standards]. *Interpretive Publications are recommendations on the application of SASs in specific circumstances, including engagements for entities in specialized industries. Interpretive Publications are issued under the authority of the Auditing Standards Board.*

The auditor should identify Interpretive Publications applicable to his or her audit. If the auditor does not apply the auditing guidance included in an applicable Interpretive Publication, the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance.

[redacted]

Auditing Fair [redacted] Measurements [redacted]

1. Auditing Interests in Trusts Held by a Third-Party Trustee and Reported at Fair Value

.01 *Question*—Entities may have interests in trusts held by a third-party trustee. For example, a not-for-profit organization (NPO) may have an interest in a trust established by a donor for the benefit of the NPO. Further, that interest may be required to be reported at fair value because it is a beneficial interest pursuant to paragraph 15 of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 136, *Transfers of Assets to a Not for Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.* Further, the fair value of that beneficial interest may be estimated, at least in part, because a readily determinable fair value does not exist. For example, the NPO may have an unconditional right to receive all or a portion of the specified cash flows from a charitable trust that has investments in limited partnership interests or other private equity securities for which a readily determinable fair value does not exist. In such circumstances, the auditor typically would satisfy the existence assertion through confirmation, examination of legal documents, or other means. In confirming the existence, the auditor may request the trustee to indicate or to confirm the trust's fair value, including the fair value of investments held in the trust. In some circumstances, the trustee will not provide management or the auditor detailed informa-

tion about the basis and method for measuring those investments, nor will they provide information about the specific investments held by the trust. For example, in some circumstances the trustee may inform management or the auditor that investments are held by the trust as follows:

- In aggregate, such as "$XXX of total investments"
- In aggregate, such as "$XXX of total investments in private equity securities, $YYY of total investments in interests in limited partnerships, and $ZZZ of total investments in debt securities"
- On an investment-by-investment basis, such as "AA shares of common stock of private company A, with a fair value of $AAA; BB shares of preferred stock of private company B, with a fair value of $BBB; CC units of limited partnership interest CCC, with a fair value of $CCC; and real estate property DDD, with a fair value of $DDDD"

In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments held by a trust, does receiving a confirmation from the trustee, either in aggregate or on an investment-by-investment basis, constitute adequate audit evidence with respect to the existence assertion and auditing fair value measurements in accordance with Section 328, *Auditing Fair Value Measurements and Disclosures*?

.02 *Interpretation*—In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments held by a trust, simply receiving a confirmation from the trustee, either in aggregate or on an investment-by-investment basis, does not in and of itself constitute adequate audit evidence with respect to the requirements for auditing the fair value of the interest in the trust under Section 328. In addition, receiving confirmation from the trustee for investments in aggregate (illustrated by the first two bullets above) does not constitute adequate audit evidence with respect to the existence assertion. Receiving confirmation from the trustee on an investment-by-investment basis (illustrated by the third bullet above), however, typically would constitute adequate audit evidence with respect to the existence assertion. Also, as noted in Section 328, paragraph .04, in discussing management's responsibility for making fair value measurements:

> Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with GAAP.

.03 In addition, Section 328 discusses the auditor's responsibility dealing with:

- Understanding the entity's process for determining fair value measurements and disclosures

and the relevant controls, and assessing risk

- Evaluating conformity of fair value measurements and disclosures with GAAP
- Engaging a specialist, where necessary
- Testing the entity's fair value measurements and disclosures
- Disclosures about fair values
- Evaluating the results of audit procedures
- Management representations
- Communication with audit committees

.04 In circumstances in which the auditor is unable to audit the existence or measurement of interests in trusts at the financial statement date, the auditor should consider whether that scope limitation requires the auditor to either qualify his or her opinion or to disclaim an opinion, as discussed in Section 508, paragraphs .22 to .26.

AU SECTION 9332

Auditing Derivative Instruments, Hedging Activities, and Investments in Securities

1. Auditing Investments in Securities Where a Readily Determinable Fair Value Does Not Exist

.01 *Question*—Entities may make investments in securities, required by generally accepted accounting principles to be accounted for at fair value, where a readily determinable fair value for those securities does not exist. For example, an entity may have an investment in a hedge fund that it reports at fair value, but for which a readily determinable fair value does not exist. Further, the hedge fund may own interests in investments in limited partnership interests or other private equity securities for which a readily determinable fair value does not exist. As part of an auditor's procedures in accordance with Section 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, he or she typically would satisfy the existence assertion through either confirmation with the hedge fund, examination of legal documents, or other means as discussed in Section 332. In confirming the existence, the auditor may request the hedge fund to indicate or to confirm the fair value of the entity's investment in the hedge fund, including the fair value of investments held by the hedge fund. In some circumstances, the hedge fund will not provide management or the auditor detailed information about the basis and method for measuring the entity's investment in the hedge fund, nor will they provide information about the specific investments held by the hedge fund. For example, in some circumstances the hedge fund may inform management or the auditor that investments are held by the hedge fund as follows:

- In aggregate, such as "$XXX of total investments"
- In aggregate, such as "$XXX of total investments in private equity securities, $YYY of total investments in interests in limited partnerships, and $ZZZ of total investments in debt securities"
- On an investment-by-investment basis, such as "AA shares of common stock of private company A, with a fair value of $AAA; BB shares of preferred stock of private company B, with a fair value of $BBB; CC units of limited partnership interest CCC, with a fair value of $CCC; and real estate property DDD, with a fair value of $DDDD"

In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments in securities, does receiving a confirmation from a third party, either in aggregate or on a security-by-security basis, constitute adequate audit evidence with respect to the existence and valuation assertions in SAS No. 92?

.02 *Interpretation*—In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments in securities, simply receiving a confirmation from a third party, either in aggregate or on a security-by-security basis, does not in and of itself constitute adequate audit evidence with respect to the valuation assertion in Section 332. In addition, receiving confirmation from a third party for investments in aggregate (illustrated by the first two bullets above) does not constitute adequate audit evidence with respect to the existence assertion under Section 332. Receiving confirmation from a third party on a security-by-security basis (illustrated by the third bullet above), however, typically would constitute adequate audit evidence with respect to the existence assertion under Section 332. Also, as noted in Section 328, *Auditing Fair Value Measurements and Disclosures*, paragraph .04, in discussing management's responsibility for making fair value measurements:

> Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with GAAP.

.03 In addition, Section 328 discusses the auditor's responsibility dealing with:

- Understanding the entity's process for determining fair value measurements and disclosures and the relevant controls, and assessing risk
- Evaluating conformity of fair value measurements and disclosures with GAAP
- Engaging a specialist, where necessary
- Testing the entity's fair value measurements and disclosures
- Disclosures about fair values
- Evaluating the results of audit procedures
- Management representations
- Communication with audit committees

.04 In circumstances in which the auditor is unable to audit the existence or measurement of interests in investments in securities at the financial statement date, the auditor should consider whether that scope limitation requires the auditor to either qualify his or her opinion or to disclaim an opinion, as discussed in Section 508, paragraphs .22 to .26. ■

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Name: The American Institute of Certified Public Accountants. (A professional association organized as a nonprofit, nonstock corporation.)

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11. Known bondholders, mortgagees and other security holders owning or holding 1 percent or more of the total amount of bonds, mortgages or other securities (if there are none, so state): none.

12. For completion by nonprofit organizations authorized to mail at nonprofit rates (Section 423.12 DMM only). The purpose, function and nonprofit status of this organization and the exempt status for federal income tax purposes: has not changed during preceding 12 months.

13. Name of publication: Journal of Accountancy.

14. Issue date for circulation data: Vol. 200, No. 3, September 2005.

15. Extent and nature of circulation:

A. Total no. of copies printed (net press run): Average number of copies of each issue during preceding 12 months: 408,917. Actual number of copies of single issue published nearest to filing date: 396,300.

B. Paid circulation:

1. Sales through dealers and carriers, street vendors and counter sales: Average number of copies of each issue during preceding 12 months: none. Actual number of copies of single issue published nearest to filing date: none.

2. Mail subscription: Average number of copies of each issue during preceding 12 months: 323,554. Actual number of copies of single issue published nearest to filing date: 297,801.

C. Total paid circulation (sum of 15B1 and 15B2): Average number of copies of each issue during preceding 12 months: 329,079. Actual number of copies of single issue published nearest to filing date: 304,774.

D. Free distribution by mail, samples, complimentary and other free copies: Average number of copies of each issue during preceding 12 months: 58,165. Actual number of copies of single issue published nearest to filing date: 60,640.

E. Free distribution outside the mail: none.

F. Total free distribution (sum of 15D and 15E): Average number of copies of each issue during preceding 12 months: 58,165. Actual number of copies of single issue published nearest to filing date: 60,640.

G. Total distribution (sum of 15C and 15F): Average number of copies of each issue during preceding 12 months: 387,244. Actual number of copies of single issue published nearest to filing date: 365,414.

H. Copies not distributed:

1. Office use, left over, unaccounted, spoiled after printing: Average number of copies of each issue during preceding 12 months: 21,673. Actual number of copies of single issue published nearest to filing date: 30,886.

2. Return from news agents: Average number of copies of each issue during preceding 12 months: none. Actual number of copies of single issue published nearest to filing date: none.

I. Total (Sum of 15G, 15H1 and 15H2—should equal net press run shown in A): Average number of copies of each issue during preceding 12 months: 408,917. Actual number of copies of single issue published nearest to filing date: 396,300.

16. Percent paid and/or requested circulation (15C/G3100): Of each issue during preceding 12 months: 84.9799%. Of single issue published nearest to filing date: 83.4051%.

17. I hereby certify that the statements made by me above are correct and complete.

Cheryl Rosen
Managing Editor

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CPA: CPA firm in Torrance, California seeks CPA. Send resume to: Toshihiko Kuwabara, C.P.A., 3555 Voyager Street, Suite 204, Torrance, CA 90503.

Accountant – Assist CPA in business counsulting and tax projects. Prepare corporate, partnership, trust tax filings; financial statements, and conduct financial analysis. Reconcile corporate books/records and tax filings using FAS-109. Required: BA/BS in any field. Must have passed 4 CPA exams from CA Board of Accountancy. Mail resume to: Kwang Hee Nam, CPA, 3700 Wilshire Boulevard, #939, Los Angeles, CA 90010.

Accountant – BA/BS in Accounting or related field plus 2 years experience. Compile and analyze financial information, prepare and audit financial reports, perform job cost accounting, provide financial advice. Job site: Bell Gardens, California. Fax cover letter, resume and salary requirements/history to: HR, Trams International, (562) 231-1780.

Accountant position – Full-charge accountant position available. Must be proficient in general ledger. Prior experience in creating journal entries, month and year-end closing, accounts payable/receivable, bank account reconciliation, payroll, inventory, short- and long-term assets. Construction accounting knowledge and experience a plus. Small company located in Sugar Land, Texas offers great benefits and long-term employment; salary dependent on experience. Email resume to: jobs@waterdistrict25.com

Sr. Accountant – Xpatrinet, Inc., in Carlsbad, California. Jobsite: Redwood City, California. Analyze accounting and financial information, prepare financial reports. Email: jobs@entriq.com

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G&J Seiberlich & Co, LLP has been providing assurance, tax and consulting services to the wine industry for over half a century. We currently seek individuals for Audit and Tax Senior positions in our St. Helena office. 3-5 years auditing or tax experience required. Knowledge of ProSystems, PPC, QuickBooks, and MS products a plus. Competitive compensation and benefits. Email resume to: danielle@gjscollp.com

CPA – Amin and Jew, LLP, located in Northridge, California, seeks an Accountant. The position requires a California CPA license and a Bachelor's degree in Accounting or equivalent and 5 years experience in systems analysis, auditing, and fraud risk assessment. Fax resumes to: Prashant Amin, Managing Partner, (818) 830-3705 or mail resumes to: 8550 Balboa Boulevard, Suite 208, Northridge, CA 91325, Attn: Prashant Amin.

Senior Accoluntant – Wanted, 5 Star Healthcare, Inc., Chicago area. Bachelor's degree in Accounting required, Master's preferred. Must have at least 5 years progressively responsible general accounting experience plus 2 years in home-health agency. Send resume to: 8001 Lincoln Avenue, Suite 702, Skokie, IL 60077. No phone calls.

Credit and Collection Manager – Kazi Foods in Studio City hires. Plans and directs risk/insurance programs. Controls risks and losses. Analyzes risks and financial impact. Degree in financial field and minimum 5 years experience required. Resume to: mkalani@cox.net

Accountant – Analyze financial information and prepare financial reports. Required: Bachelor's in Accounting or Economics or Humanities or related field and 1 year experience in job or 1 year experience as Research Analyst in Finance area. Send resume: Ferdinan T. Castillo, Ferdinan T. Castillo, DDS Office. 28472 Hesperian Boulevard, Hayward, CA 94545. (Jobsite).

Accountant – Schedule payroll for deposits, prepare quarterly payroll reports and file compliance reports with state, city and county agencies and manage payroll process. Coordinate with retirement administrators and provide report to comply with ERISA reporting requirement. Job site: Los Angeles. Send resume to: Joan O. Tan, CPA, Inc., 3235 Wilshire Boulevard, Suite 350, Los Angeles, CA 90010.

Auditor – Perform detail financial audit and review. Required degree in Accounting Sciences and experience. Mail resume to: Ms. N. Knighten, HR, #Y/S-10 MJLM, LLP, 3040 Post Oak Boulevard, Suite 1600, Houston, TX 77056.

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Auditor sought by company who manages family restaurants located in Orlando, Florida. Bachelor's degree or equivalent required, Major in Accounting plus 1 year experience specifically in the food service industry. Mail resume to: Mr. F. Olama, Olama Management, Inc., 440 South Semoran Boulevard, Orlando, FL 32807.

Accountant for a swimwear manufacturer located in Los Angeles, California. Jennifer Kay, Inc., Attn: Office Manager, 1247 East 58th Place, Los Angeles, CA 90001.

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Accounting Supervisor – Hialeah, Florida. Seeking candidates with Bachelor's degree. Prepare, examine and analyze accounting records, financial statements; analyze business operations, trends, costs, revenues; report to management regarding finances of establishment. Candidate must be fluent in English and Korean. Resume to: Larry Pata, Jinny Beauty Supply Co. Inc., 16241 North West 48th Avenue, Hialeah, FL 33014.

California Earthquake Authority (CEA) is soliciting proposals for claim file auditing firms. The requirements are listed in our RFQ 52 which can be retrieved from the CEA web site at: www.earthquakeauthority.com or contact the CEA directly at: (916) 325-3800.

Quality Control Reviewer – Established public accounting firm located in northern New Jersey seeks an experienced professional with knowledge in the following areas: Peer review, engagement planning and management, ERISA, proactive training, and presenting seminars. SEC/PCAOB experience a plus. Email resume with salary requirement to: qcresumes@yahoo.com EOE.

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Accountant – Experienced and self-motivated accountant needed. Excellent salary. Resume to: CBIZ Southern California, 11601 Wilshire Boulevard, Suite 2300, Los Angeles, CA 90025.

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Miscellaneous

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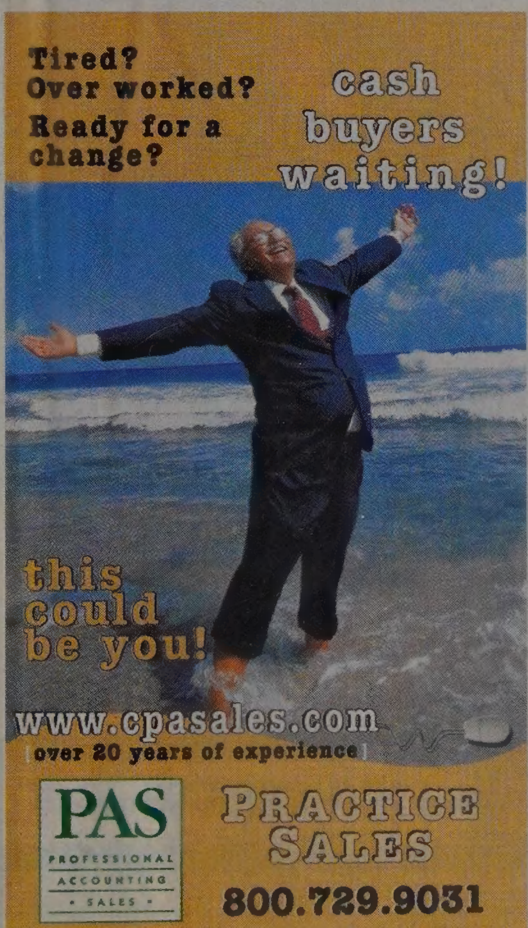
New Jersey – Regional CPA firm wishes to acquire or merge with retirement-minded practitioners. Reply to: Box #195, c/o JOA, P.O. Box 1510, Clearwater, FL 33757-1510.



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Hawaii – Two practices in the greatest U.S. state. Details at our web site: www.Apractice.com

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The Last Word

I majored in accounting because I wanted to do something in business but didn't know what—and I figured an accounting degree would give me more options in whatever I chose to do. The best thing about public accounting is the chance to communicate with and help a variety of people instead of just being behind a computer.

TONYA VARNER, CPA
Senior consultant, Anderson ZurMuehlen & Co.
Operation CPA volunteer
Billings, Mont.

PHOTOGRAPH BY LYNN DONALDSON/BLACK STAR

I started my public accounting career at a Big Four firm, but I wanted to be in town more than that position allowed. I was referred to Anderson ZurMuehlen & Co. PC (AZ), a regional firm located primarily in Montana, by a college acquaintance. Working at AZ allowed me to get involved with my community, in things such as Operation CPA, the Montana State Society's Financial Literacy program for deployed soldiers and their families. My father has been in the National Guard all my life; he's a command sergeant major. So I have a very personal tie. It's not our parents' war any more; it's our brothers and sisters and loved ones who are on the battlefield. At one Operation CPA meeting we provided a briefing for 200 soldiers and their families: We gave them tax and financial information, a summary of financial issues to think about—such as getting a power of attorney—and lists of CPAs who are involved in the program and willing to give advice at reduced cost.

I sat for the CPA exam the day before I graduated and passed the first time. It would have been extremely difficult for me to study for it after I started working.

I enjoy working in public accounting. I've worked in various areas, but my primary specialty is construction—home and commercial builders. My previous experience was in banks and financial institutions, but AZ's niche in the construction area provided a great opportunity for me to move into the industry.

I grew up in Terry, a town of 600 people, where my dad's been the mayor for more than 20 years. My parents taught me the values of small-town America. I think it's important to give back to the community that helped to raise me. And I enjoy volunteering. In addition to working with Operation CPA, I'm a senior high school youth adviser at my church; I work with Relay for Life, a fundraising program of the American Cancer Society; I serve on the boards of the Billings chapter of the Montana Society of CPAs and the MSU-Billings Campus Ministries. This month, I'll be cutting my hair, which I've been growing for the past 18 months, and donating it to Locks of Love, a charity that makes wigs for children who have lost their hair.

I've had a lot of mentors. In public accounting you learn from the people ahead of you more than anything else; the practical application is very different from the theory you learn in school. My advice to new CPAs is not to get discouraged about how much you don't know. Experience will help connect the academic knowledge with the real-life applications. And take time for yourself. Hold onto something you really, truly enjoy. I love running and being outdoors. So I make time to enjoy it, even just to take a break from work.